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WASTE, FRAUD, AND ABUSE

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

PART 1

OPEN, CLASSIFIED, AND COVERT ACCOUNTS

FEBRUARY 18, 1987

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WEDNESDAY, FEBRUARY 18, 1987

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WASTE, FRAUD, AND ABUSE

WEDNESDAY, FEBRUARY 18, 1987

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m., in room SD-342, Dirksen Senate Office Building, Hon. John Glenn, Chairman of the Committee, presiding.

Present: Senators Glenn, Levin, Sasser, Bingaman, Roth, Heinz, and Cohen.

OPENING STATEMENT OF CHAIRMAN GLENN

Chairman GLENN. The hearing will be in order.

I am pleased to welcome my colleagues and today's distinguished guest Comptroller General Charles A. Bowsher, and his colleagues, to this first hearing of the Governmental Affairs Committee in the 100th Congress.

This committee, above all committees in Washington, has more of a direct oversight role to play across the whole scope of government than any committee on Capitol Hill.

It functions in two areas, basically, one in organization and the other in efficiencies of government. Our mandate is across the board wherever we want to look in government. So that is the reason this hearing this morning, as a kickoff hearing, is to me so important.

I have asked Mr. Bowsher to give us a no-holds-barred picture of management and accountability in government, and the importance of this issue cannot be overestimated.

The failure to properly manage the government is a contributing factor to the series of $200 billion deficits that we have had under this administration. In fact, the accumulated deficit under the stewardship of this administration now exceeds 2 trillion dollars. Those deficits and that debt constitute a figurative dagger pointed directly at the heart of the future prosperity of the American people.

One of the responsibilities of this committee is to help ensure that the executive branch of our government spends every taxpayer's dollar appropriated to it with economy and efficiency and in a manner fully consistent with our laws and the intent of Congress. It is the job of this committee to help expose and eradicate the fat, fraud, waste, and abuse that we all go back and make speeches about but never seem to get around to doing enough about. That is the job of this committee.

So I am deeply concerned by indications that the public perceptions of fat, fraud, waste, and abuse in government programs will undermine further the confidence of the American people in Federal spending programs vital to educate our children, to care for our needy and sick, to clean up our environment, and to provide an adequate defense of our Nation.

Therefore, part of the agenda of this committee must be to ensure that every agency in this government is properly held to account for the funds and programs that they control: from the person who purchases paper clips to the persons who dispense "humanitarian" aid money to contras, foreign aid money to the Philippine government, TOW missiles to Iran, for money going somewhere else.

As we have learned in the past few months, the lack of accountability in our covert programs has brought our foreign policy into disarray. I have specifically asked Mr. Bowsher to discuss this lack of accountability, and specifically to discuss the GAO's access to and ability to audit agencies such as the Central Intelligence Agency, and other agencies in the intelligence business.

This hearing is not focused just on the Iran/Contra affair. That is very properly the domain of the select committee that will be chaired by Senator Inouye with Senator Rudman serving as ranking minority member. But the Iran/Contra affair does provide an example illustrating the problems in attempting to audit covert accounts.

Covert accounts are not our only problem. Fundamentally I am deeply concerned that our government does not have adequate audit and management capacity to assure the American people of where their money is going in open as well as secret programs.

In the audit and control area, successes like the Inspectors General offices must be tempered by the realization that a number of Federal agencies cannot meet the elementary financial accounting requirement of balancing their books. Mr. Bowsher will, I hope, tell us why this state of affairs exists.

Corresponding Federal management problems are equally disturbing. It appears the military, GSA or other agencies cannot adequately manage and account for our huge inventory of Government purchased weapons, gear, and equipment.

The Federal procurement system spends hundreds of billions of dollars based on assumptions and cost allowability and allocability systems that leave the Congress and executive with only the haziest picture of whether we are spending more than we need to procure the vitally needed military equipment to defend our country. Recent DOD and GAO studies indicate we may literally be spending several billion dollars per year more than is necessary to acquire our weapons and ensure industry enough profit to sustain a strong defense base. Our acquisition profit policy will also be an important aspect of our dialogue today.

Finally, similar issues exist as to the basic functioning and decision-making infrastructure of the Government. Are we attracting the management employees and leaders we need? Do our employees have the tools they need to do the job? I have asked Mr. Bowsher to give us a picture of the broad agenda of changes needed to advance all segments of the U.S. Government into new management practices and technologies—from new generation computers to more sophisticated accounting methods. These are the type of items that will provide agency decision-makers—and the Congress—better and more timely information so that Government accountability is enhanced. And let us make no mistake about this. Without accountability, without the confidence of the American people that their government agencies are law-abiding and careful in handling the taxpayers' money, we risk creating a level of cynicism, both inside and outside government, that could undermine our democratic institutions.

Chairman GLENN. Mr. Bowsher, we welcome you and your colleagues this morning.

Mr. Bowsher, as I said, is Comptroller General of the United States. He is accompanied by Milton J. Socolar, Special Assistant to the Comptroller General; Frank C. Conahan, Assistant Comptroller, National Security and International Affairs Division, and Frederick D. Wolf, Director of the Accounting and Financial Management Division.

We welcome you all this morning.

I turn this over to Mr. Roth, for any comments he may have.

OPENING STATEMENT OF SENATOR ROTH

Senator ROTH. Thank you, Mr. Chairman.

I first of all want to say how very pleased I am that we are having this hearing this morning to review Federal management, and in particular, the condition of the government's financial systems. In a very real sense, this hearing takes up where we left off at the end of the last Congress in Governmental Affairs in trying to revitalize the government's financial management structure, so that those who spend government funds, will be held accountable to the taxpayers who pay the bill.

Now as members of this committee know, last year I introduced the Omnibus Federal Management and Financial Management Reform Legislation, S. 2230. That bill was the result of a 2-year effort by the committee, with tremendous assistance, Mr. Bowsher, from your group, as well as from the Grace Commission and the Office of Technology Assessment.

Working from this legislative initiative, the committee made a concerted bipartisan effort to develop consensus on how to provide determined leadership to put the government's financial house in order.

The result of that effort was the unanimously reported bill to put in place a single administrator for financial management. I think that's a critical step if we're really going to do something to improve financial systems in the executive branch of the government.

I will be very interested in your comments on this, Mr. Bowsher. The bill would also require major agencies to prepare annual financial statements of their activities subject to regular audits, to provide tools to stop the annual loss of millions of dollars from the Treasury because of untimely transfers or failures to pay our bills and set up tough new measures to collect the billions of dollars in debt now owed to the government by delinquent private borrowers.

Some progress has been made by the Reagan administration in this area of cash management, but I think it's obvious that the legislative reforms the committee worked so hard to put in place in the last Congress are needed now more than ever.

I know, as our distinguished chairman well knows, this committee has a long history of strong bipartisan leadership and action to improve Federal management. Over the past half-dozen years, we have worked together on the committee to pass a single audit bill, the Federal Managers Financial Integrity Act, a Prompt Payment Act, and Debt Collection, among others.

These laws were the product of the committee's continuing efforts to get the government's books straightened out, to get our bills paid and payments received on time, and to assure financial accountability. These were important steps toward revitalizing the Government's dilapidated financial structures. I know that you will discuss with us today some of the critical gaps that remain.

Now there are some horror stories that can be brought out, and frankly, there is some merit in this approach, as it's one way of getting something done in the Congress. But I think it is particularly important that we begin to put into play some of the basic reforms—not very exciting, not making many headlines generally—but that will provide the basis of accounting, internal control, and auditing systems that will discourage fraud in the future, and will provide adequate, accurate, up-to-date information on how to run this government.

Let me just say, in closing, that the committee in the last Congress unanimously reported, and the Senate adopted, S. 2005, which would have extended the Inspector-General concept to a number of agencies that have had deficient internal audit systems.

Mr. Chairman, I am delighted that you intend to pursue this legislation because I think it is important that we do so.

Mr. Chairman, I look forward to working with you, and Mr. Bowsher, and others on these very important management control matters.

Chairman GLENN. Thank you very much, Senator Roth.

Senator Bingaman, do you have any comments?

Senator BINGAMAN. I had no opening statement. I am looking forward to the testimony.

Chairman GLENN. Senator Cohen? Good, fine.

Mr. Bowsher, we look forward to your statement. I understand you have a lengthy statement but have an abbreviated version you can give to us. The entire statement will be entered in the record without objection from any member here, so proceed, and then we'll get the questions.

TESTIMONY OF CHARLES A. BOWSHER, COMPTROLLER GENERAL OF THE UNITED STATES, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY MILTON J. SOCOLAR, SPECIAL ASSISTANT TO THE COMPTROLLER GENERAL, FRANK C. CONAHAN, ASSISTANT COMPTROLLER GENERAL, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, AND FREDERICK D. WOLF, DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION

Mr. BOWSHER. Thank you very much, Mr. Chairman, and members of the Committee.

I do have a lengthy statement so I will summarize it here.[1] First, though, I would like to congratulate you, Mr. Chairman. I believe this is the 25th anniversary of your flight in orbit, and I think that, of course, all of us remember with great pride, and we want to congratulate you.

Chairman GLENN. That occurs on Friday. I am trying to forget that 25. That seems too long.

Senator COHEN. Some of us maintain he still is in orbit.

Chairman GLENN. That's the opposition.

Senator COHEN. Especially after assuming the chairmanship of the committee.

Mr. BOWSHER. We are pleased to be here today to talk about the need to strengthen and improve the government's overall financial management systems and agency operations and overall accountability. Demands to fund current programs as well as to provide for new investment in national defense and capital improvements continue unabated.

However, with annual deficits exceeding $200 billion, and an accumulated deficit over $2 trillion, the shortfall in meeting government outlays is critical, and our management processes have not been able to cope with this situation.

As the Congress and the President grapple with the budget deficit, it is imperative that ongoing operations be as efficient and effective as possible. We must be sure that every dollar is spent wisely and that there is full accountability.

Based on audits and evaluations of the major programs and operations of the government that GAO has completed during the 6 years I have been Comptroller General, I believe there are four areas that demand our immediate attention if we are to bring about necessary improvements.

First and foremost, I believe that the deficit of the Federal government is the major problem which faces us today, and it must be dealt with.

Second, the financial management systems used and concepts followed by the Federal government are inadequate to deal with a trillion dollar Federal government operation.

Third, I have major concerns about the management of the operations of some of our major government activities and programs, such as the IRS, the FAA, the Farm Credit System, and the Social Security Administration's computer modernization program, which affects the lives of millions of our citizens.

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[1] See p. 45 for the statement and attachments.

Lastly, I believe that the accountability to both the public and the Congress in such areas as defense procurement, international assistance, and intelligence is inadequate.

Now, yesterday I gave a speech in San Francisco on the deficit issue, which I am submitting for the record.[1] This morning, I would like to focus on the other three issues—financial management, agency management, and accountability—since they are important both to ensuring that we effectively and efficiently carry out our public mandate and to dealing ultimately with our federal deficit. I would like to outline for you the problems in these areas and then focus on a series of suggestions which we believe would begin to deal with these problems.

First is the financial management. This is an area that we at GAO have done a lot of work in in recent years, and we really do believe that it is important to get on top of the accounting systems and the budgeting systems of the government.

Our systems are old; they are in bad shape. We can go into practically any department and find really significant problems. We have illustrated a couple here in the statement with the Veterans Administration and some of the others, but basically what we have is a situation where in World War II, the General Accounting Office, the organization I head, could no longer handle the volume of the accounting documents; therefore, we had to delegate it to the executive branch. This was put into legislation in 1950, and many of the systems that are in place today go back to that era.

There has been some computerization, but by and large, we have 450 individuals systems in the Federal government today. Many of them are very old; many of them are using 1950's computer technology. What we do not have is a modern system where we can process the data to the decision-makers in the executive branch or to the Congress here, both on the budget and on the accounting as to actually how the money is spent. That is important. We have got to have the scorekeeping at the end of the fiscal year as well as at the beginning of the fiscal year.

Now, I would like to speak on agency operations. There we have been doing a number of what I call agency-wide reviews of the Justice Department, of the Department of Transportation, and HUD. We are currently doing Social Security Administration, and the IRS. What we are seeing is two or three major problems. What we are seeing is a lack of continuity of leadership.

In other words, we have too much turnover of the political appointees. We have too many periods where we do not have political appointees in the positions. And we also are seeing a rapid turnover today of the Senior Executive Service. In other words, the senior civil servants of our government are not in the positions for very long, and so we see lots of times different efforts, like new systems started, but we do not see them brought to a successful conclusion. I think that we are spending millions and millions of taxpayer dollars on some of these new systems, and we are not getting them in place and we are not finding that they work very well.

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[1] See p. 91.

So I think truly some of the problems that we have seen in the Social Security Administration with their systems, at the IRS with their systems and that are the kind of ones that we have to be concerned about in the future here in some of our major departments.

Now, on accountability. I have been concerned for some time about the accountability, especially for contractor profitability in government contracts. There is ample reason for concern when government procurement is almost $200 billion a year, much of which is awarded through negotiated, noncompetitive contracts.

The cost of our national defense has increased by almost 100 percent since 1980, and the procurement is a major share of this growth. Over the past two decades, Defense has performed two major studies to assess its contractor profit policies; the latest, completed in 1985, was the Defense Financial and Investment Review, sometimes referred to as DFAIR.

GAO performed a review of the DFAIR study for this committee and found the profitability information in DFAIR to be seriously misleading. We concluded that profits of defense business were substantially greater than reported and substantially higher than in the commercial sector.

Another important facet of government accountability is the audit of the the proper control over all government accounts, including sensitive accounts. Establishing proper accountability over some programs is difficult because of their very nature. For example, our reviews of U.S. foreign assistance programs in the Philippines and other countries identified control and accountability problems which resulted in diversion of funds to unauthorized use.

Concerns about accountability frequently surface over government activities and programs which are not subject to normal public scrutiny, such as the very secretive military weapons projects—sometimes called "black" programs—and sensitive intelligence activities. Programs of this nature require special access and are known to a relatively small number of people. Over the past several years, we have increased our audits and reviews of these activities. We have been successful in obtaining access to review highly classified weapons programs and tactical and strategic command, control, communications, and intelligence programs.

The one major exception has been the Central Intelligence Agency activities. Here we have been unsuccessful in gaining similar access. The CIA takes the position that GAO's involvement in reviewing CIA activities is not necessary because the select committees on intelligence are the Congress's oversight mechanisms.

Now, these are the various problems that we feel are the major ones that we wanted the committee to hear today. We do believe there are solutions to these problems, and I would just like to outline them for you very quickly.

First, in the financial management area, there are really five things that have to be considered. One is the very issue, Mr. Chairman, and the one also that Senator Roth brought up, and that is centralized leadership.

In other words, you have to have somebody in the executive branch responsible for financial management. You have to have a financial management program, a reform plan. You have to have audited financial statements to achieve discipline and accountability. We have to upgrade these accounting systems not only to provide fund control, but needed financial and management information as well. We also need budgets that include costs and long-term investments along with receipts and outlays. We have to be focusing more on improving the internal controls.

In 1985, GAO proposed a conceptual design for a modern financial management system for the Federal government in a report that we called "Managing the Cost of Government," which I am submitting for the record along with a joint study on Federal reporting that we conducted with the Auditor General of Canada. In 1986, I also commented extensively on this issue in a letter to Senator Proxmire which I have also included for the record.[1]

Second, we need to upgrade our major agency operations. GAO plans to continue its agency management reviews to focus on high level management problems. The agencies' leadership has reacted positively to our management reviews, and I would hope that the Congress will use these reviews and other means to begin to address some of these long-standing major problems. The Congress, together with GAO, needs to focus on the major operations of the government.

Third, we need a program for defense contractor profitability reporting. We have a recent exposure draft outlining a program for contractor reporting and verification of that data by external auditors as a means to begin to deal with this problem and help assure fair and reasonable profit in the negotiation of government contracts. I am providing you a copy of that draft which contains suggested legislative language for a bill to implement an acceptable profitability reporting program.[1]

Finally, we need to improve accountability and oversight of sensitive government activities. If the Congress were to determine that GAO should be involved, legislation to clarify this matter would facilitate our auditing of the CIA. We are prepared to carry out that responsibility. And I believe GAO could be very helpful in assisting the Congress in its oversight of these important and sensitive activities.

In conclusion, Mr. Chairman, while the problems I have outlined are significant and long-standing, there are ways we can begin to solve them. I believe there is a positive role for the Congress in addressing each of these issues, and we want to work with you and your committee in improving government operations and management. I have attached a more detailed discussion of these issues, as we said at the beginning.

Mr. Chairman, that concludes my summary remarks.

Chairman GLENN. Thank you, Mr. Bowsher. I appreciate that very much. Your longer statement will be entered in the record.

As far as your last suggestion, I can assure you that we want to work with you. I personally want to work with you very much if we need legislation to improve GAO oversight into any areas, including the sensitive areas. That is an area that requires very special considerations, obviously, as to the type of people who do the oversight work, that is, whether they work at agencies that are involved with intelligence activities, do you do it in your shop, how do you make certain that we are not endangering people's lives by letting more people have access to information. These are the things that I think we really have to work out, and we want to work very closely with you on that.

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[1] The information referred to may be found in the committee files.

We will follow a 10-minute rule here, and we are following the early-bird rule also on those we recognize that come in after the hearing has started.

Mr. Bowsher, has GAO ever received specific congressional requests to audit secret and covert accounts at CIA?

Mr. BOWSHER. We have received requests, but when we went out to do the work, the CIA pointed out that the intelligence committees were responsible for oversight of its activities; and when sought the support of the intelligence committees, they always took the position that they would handle the oversight. Therefore, we have not done audits out at the CIA.

Chairman GLENN. Do you know in all these accounts on intelligence what they are being used for? Does the Intelligence Committee, in fact, then run an audit of any kind? Do they do any auditing of accounts other than just what the programs are? Do they allow a money trail?

Mr. BOWSHER. They get data from hearings and do some checking. The CIA has an internal audit function, but we have never reviewed it.

Chairman GLENN. You have never given the Intelligence Committee any advice on how to set that up if they want to actually monitor accounts on where the money goes?

Mr. BOWSHER. No, generally we have not. One exception is the $100 million Contra aid program. In authorizing that program the Congress required the CIA to consult with us about proper controls. Our people did meet with the CIA people in that regard.

Chairman GLENN. And gave them?

Mr. BOWSHER. We gave them advice. We do not know to what extent that advice was implemented.

Chairman GLENN. And do you know whether the Intelligence Committee actually follows any specific accounting procedure on following where those accounts go and what happens to the money?

Mr. BOWSHER. Frank, do you have anything you want to add to that? I do not believe they do what I would call an audit.

Mr. CONAHAN. After meeting with the representatives of the Central Intelligence Agency, we talked with the staffs of both the House and Senate Select Committees on Intelligence, gave them our views on the procedures that CIA intended to employ with respect to that program, and asked if they intended for GAO to have any continuing role.

The answer in that respect was no, and they did not then share with us what they intended in terms of monitoring that program.

Chairman GLENN. Do you have experience in monitoring other covert programs or other "black" programs? And could you give us some information on that? Do you monitor NSA funds?

Mr. BOWSHER. Yes, we do.

Chairman GLENN. The DIA? Give us some information on that.

Mr. BOWSHER. Yes. We have had an audit group out at NSA for many years, and we have audited those programs. We also have audited many of the highly secret defense programs in the Air Force and Navy and Army budgets. So we have a long record of experience in auditing very sensitive secret programs. The CIA has been the exception.

Chairman GLENN. We gave you authority, I believe it was in 1980, to get into some of the unvouchered accounts.

Mr. BOWSHER. Yes.

Chairman GLENN. I worked with Senator Roth, I believe, and others on the committee at that time to get that authority for you so that we covered some of those accounts that were White House-controlled accounts, to some extent. This was back before this administration when we were working on that.

Mr. BOWSHER. The late 1970's.

Chairman GLENN. I think you have indicated in the past, I believe, that that helped considerably in getting into some of these accounts. Were the accounts in the Iran situation, were they kept completely secret and separate from any auditing that you did at the White House?

Mr. BOWSHER. To the best of our knowledge, they were, Mr. Chairman. In other words, when we did the unvouchered audit of the White House the last time, we did not discover any of these Contra aid or Iran moneys flowing through those accounts.

Chairman GLENN. Did your authority to monitor the unvouchered accounts at the White House, was it your view that that included everything they did at the White House, that the Iran thing should have been part of what information you were getting?

Mr. SOCOLAR. The intelligence activities were exempted from the review.

Chairman GLENN. At the White House as well as at CIA.

Mr. SOCOLAR. Yes.

Chairman GLENN. Just so we clarify that, that was specific. In the General Accounting Office Act of 1980 Congress specifically exempted the CIA from coverage of that act by referring back to a section of the original law authorizing CIA, which states that, "The sums made available to the agency may be expended without regard to the provisions of law and regulations relating to the expenditure of government funds; and for objects of a confidential, extraordinary, or emergency nature, such expenditures to be accounted for solely on the certificate of the Director and every such certificate shall be deemed a sufficient voucher for the amount therein certified."

Chairman GLENN. That really takes it out of your control, I would presume.

Mr. BOWSHER. I think it does.

Chairman GLENN. Is that what you referred to earlier in your statment?

Mr. BOWSHER. Yes, as far as those accounts over there.

Chairman GLENN. Do you think the outcome of the recent Iran/Contra problems might have been different if some of the participants and their agencies recognized that an external audit were prepared to look at the documentation.

Mr. BOWSHER. It is hard to say if an external audit in place would have had an affect in that particular case. But generally we believe such audit oversight can have a deterent effect.

Chairman GLENN. Just one more question. Is it your opinion that any of this money went into some of the offshore bank accounts that have been alleged or have been rumored in the papers?

Mr. BOWSHER. I think there is a possibility that some of it could have gone there, yes.

Chairman GLENN. What likelihood would you put on that? High, low? Do you think a lot of the $27 million went into private offshore accounts, was funnelled off and did not get into humanitarian aid?

Mr. CONAHAN. We saw individual transfers to offshore accounts, although not in large amounts. We could not track it beyond the offshore accounts.

Chairman GLENN. You actually tracked a paper trail into offshore accounts for some of that $27 million?

Mr. CONAHAN. Yes, sir, but not names on that.

Chairman GLENN. In the names of specific officials?

Mr. CONAHAN. Generally speaking, no.

Chairman GLENN. How about very generally speaking? Was it yes or no?

Mr. CONAHAN. We could identify Spanish surnames in some cases.

Chairman GLENN. I am over my 10 minutes. I am sorry, Senator Roth. I will pursue this later on. Thank you.

Senator ROTH. Let me ask you this, Mr. Bowsher. Do you have authority to secure any records currently that are necessary for audit purposes?

Mr. BOWSHER. Well, regarding intelligence data, there is a problem.

Senator ROTH. Before we go to that, do you have the authority? I think that is the key question.

Mr. BOWSHER. We have the authority to look at the records. Absolutley.

Senator ROTH. Have you subpoenaed them?

Mr. BOWSHER. We could subpoena them.

Mr. CONAHAN. We are speaking about the CIA specifically. We have had a long-standing controversy with the CIA.

Senator ROTH. No. The question I am asking right now is whether you have the authority.

Mr. BOWSHER. Are you talking about the $27 million?

Senator ROTH. Well, to secure any accounting records that are necessary for the purpose of audit?

Mr. CONAHAN. We have a special procedure. If any agency over which we do have the authority refuses to provide records, there is a special procedure written into the law under which we can test that issue in the courts.

Senator ROTH. Can the State Department, for example, deny you a record and you have no authority to secure them?

Mr. CONAHAN. If the State Department denies us records, we can bring the issue into court.

Senator ROTH. You can bring the issue into court?

Mr. CONAHAN. Yes.

Senator ROTH. I think it is an important point.

Mr. Bowsher. In fact, Mr. Chairman and Senator Roth, that was part of the legislation that this committee and the Congress gave us there in the 1980 act.

Senator Roth. It seems to me that is an important authority that you have to have.

Mr. Bowsher. That is right.

Senator Roth. Let me ask you this question. As I understand it, you do audit so-called black accounts and you secure them, and you have a special group that I assume has received classified security?

Mr. Bowsher. That is correct. We have a select number of people who have very high security clearances.

Senator Roth. You say you have had controversy with CIA and have been unable to get the kind of cooperation you want. That concerns me, and I think this is a matter that ought to be reviewed with the leadership of the Intelligence Committee. I think it is important that these funds as well as others be subject to an independent audit to make sure they are spent as intended.

But I intend to ask the proposed Director, Mr. Gates—we are having confirmation hearings and I am a member of the Intelligence Committee—as to whether he will sit down with you and try to work out a satisfactory relationship.

I think we have to understand our special concerns, as the chairman properly brought out. We have lives at stake, and covert action, frankly, is a dirty business. Nobody particularly likes it, but it seems to be essential—at least in some people's minds—in today's world.

Is this something that can be worked out with sitting down with the Intelligence and the Director and Government Affairs leadership?

Mr. Bowsher. I think it can be worked out much better, but I am not sure that we will not need some clarifying language from Congress. I will give you the two examples.

In other words, in the mid-1970's, Congress finally gave us access to the IRS, and I think with events that have happened the last 10 years, why, that has proven very beneficial for the Congress.

Senator Roth. Well, I will be very happy to work with you and the Intelligence Committee and others, to see that whatever authority is necessary and consistent is granted because I share the concern if you are not receiving any access to this information.

Mr. Bowsher. One thing, Senator Roth, that I would like to point out is that I am not sure we should have access to some of the small or the human covert operations. In other words, it is like the Federal Reserve System which was the other agency of government that the Congress gave us access to in the 1970's; that is, there are a couple of areas there that we do not review. In other words, we were able to work out with the Federal Reserve System two areas that GAO does not review, but we can review everything else. Before that legislation, we were kept out of reviewing the Federal Reserve System.

Senator Roth. Well, you raise a point of real concern to me. I suspect that any covert action at any time, if you go back afterwards, might produce things that you and I in the normal course of business think is outrageous. I guess the question is whether or not we think they are essential for the security of this Nation.

So I think some common sense does have to be applied, and I would not want to see this become a media focus. This is the sort of situation that could produce dramatic headlines but we have to decide whether or not there is some intelligent way of ensuring that the money is spent as proposed, and yet not lift the cover so that it is impossible to conduct such operations.

Let me ask you this question. We have mentioned CIA. Are there any other, anywhere in government, any accounts, unvouchered accounts and so forth which we are having this kind of difficulty?

Mr. BOWSHER. No. The only two areas that the GAO does not audit today in the Federal government is the CIA, and certain aspects of the Federal Reserve System that is, the foreign operations and the money market policies.

Senator ROTH. What do you think we should do in regard to the Federal Reserve?

Mr. BOWSHER. The foreign operations systems worry me a bit based on some of the work we have done in the Treasury, but I see no reason why we have to audit the money market policies in the Federal Reserve. I can certainly understand the concern of the Federal Reserve on the foreign operations because of the concerns of the central banks, the other countries' central banks. But I think it is important. I think it goes back to the issue of accountability.

In other words, I think that we ought to have adequate systems, both in the Treasury and at the Federal Reserve, to handle our foreign operations, and that is the only part that I would really be putting up as a possible addition.

One other thing—if I could just take 1 minute—I think that the reporting of our work in this type of area could also be done in a selective manner. In other words, in no way are we trying to get in a situation where we would be reporting in public on things that should not be made public. But we do believe that Congress might well need to have highly classified reports as to what is going on in some of these areas.

Senator ROTH. Two other areas I want to get involved in. First of all, I want to compliment you for being here this morning. I understand you were on the red eye from San Francisco last night.

Mr. BOWSHER. That is right.

Senator ROTH. You look more rested than I do coming from Delaware.

You mentioned about the profits. I would like to ask that GAO—and I would hope that the chairman might join me—would make a detailed study on this profit picture. You make some very, very serious charges when you say profits are in excess of those produced commercially.

So I would hope that this committee could have, and I would hope the chairman would join me in asking that we would have a study made to spell out the profit picture and how it compares with the commercial and across the various departments in the Pentagon.

Mr. BOWSHER. I think what is important, Senator Roth, is that the profitability studies that are done have to be done on a periodic basis, not every 10 years like they have been done, but say every 3 years; and we have got to have criteria that everybody agrees to.

What has happened in the last three studies, as I say, done over the last 20 years that criteria change each time. Therefore, the confidence in the study results is limited.

Senator **Roth**. I agree, and I think that would be helpful.

Mr. Bowsher, let me go to a more general question that I alluded to in my opening statement. As bad as some of these situations are, the thing that concerns me the most is that we do not have standard accounting practices in the Federal government between agencies. No one, but no one, really knows exactly about what is being spent.

In fact, I have heard you for the last I do not know how many years come here again and say how in 1950 and subsequently we have come to get some kind of a standard kind of accounting process followed.

I would like to know how important you think this is in the order of priorities. I personally think that, with respect to financial management, nothing is more important that we have these standard systems put into effect. That means you have got to put somebody in government in charge who has the authority. If the agencies will not do it, it seems to me they have got to have the authority to move in and do it.

I would just like to have your comments.

Mr. **Bowsher**. I think it is awfully important, Senator, because——

Chairman **Glenn**. Could I interrupt just one second, if I could?

Did I understand you along that line in your opening statement to say that we have 450 different accounting systems in government?

Mr. **Bowsher**. That is correct, Mr. Chairman.

Senator **Roth**. And he has been screaming about that for 15, 20 years.

Chairman **Glenn**. Go ahead. I am sorry. I just wanted to clarify that point.

Mr. **Bowsher**. I think it is awfully important in the financial systems because I think when people pay their taxes, they assume that the government who has taken their money is going to have control over that money, they are going to have control of the inventories that they buy.

We have issued reports this past year on thefts from some military installations. Reports on where some stolen explosives may be going are very scary. And so I think that it is awfully important that the government have good accountability, good internal controls, and can adequately describe where the assets are, where the money went. And I think the focus for years has been on the budget, next year's budget, the next year's budget, and nobody is worrying enough about the accounting systems and how we are spending the money.

Senator **Roth**. Could I just ask one follow-up question? Is it not important that somewhere in government, in the executive branch of government——

Mr. **Bowsher**. Absolutely.

Senator **Roth** [continuing]. We give a chief financial officer the authority to see that this is done?

Mr. BOWSHER. We met with the Treasury officials the other day and again pushed that issue very, very hard. Either it has got to be done at Treasury or there has got to be a new function set up or something, but you have got to have that function and it has got to work. It has not worked, really, since 1950.

Senator ROTH. Thank you, Mr. Chairman.

Chairman GLENN. Thank you. Under our early-bird rule, Senator Bingaman.

Senator BINGAMAN. Thank you, Mr. Chairman.

Let me ask about the issue that Senator Roth mentioned earlier, the profitability question. As I understand your proposal, you are recommending the establishment of a new agency which would be the Office of Profit Studies and Analysis that would look into the question of profitability of all contractors that do business with government, not just defense contractors. Is that accurate?

Mr. BOWSHER. Well, it would be primarily defense contractors because of the threshold that we have suggested, but it would include some contractors like with NASA and some of the other big government programs.

Let me also point out, Senator, that this can be an existing agency. In other words, one of the groups we have suggested might be considered would be OFPP, and they could even contract with somebody like Logistics Management Institute.

So it is not really creating a big new bureaucracy. What we are really saying is that we think there ought to be some central place—again, in the government—that receives this information on a periodic basis and then does some analysis on so that the decision-makers can then decide whether the profitability—or the weighted guidelines used in negotiating these contracts should be raised or lowered.

Senator BINGAMAN. But I gather that whether it was a new agency or an additional function of an existing agency, you are contemplating a new group of auditors that is not present in the field. Is that wrong?

Mr. BOWSHER. No. We are not doing that because, in fact, one of the things that we have suggested in our exposure draft is that the auditors of those contractors could check the information to make sure it was right as it was sent in. So we are talking about really a small group of people who would really do the analysis, I would say, rather than audit it. And if anybody did any auditing or review of the overall study, I think it would be GAO.

Senator BINGAMAN. Now, am I correct in thinking you are suggesting here that certain profitability levels be permitted in the statute or otherwise by regulation?

Mr. BOWSHER. No. It is really to try to get good information, and then it is up to the leadership in the government, the people that have the positions, as to what should be the proper level.

In other words, I know that the defense industry is concerned about this suggestion because they feel that it will be used to control their profits. And I can understand their concern.

But what we are advocating here is nothing more than proper disclosure of costs and profitability, and doing it on a basis that everybody agrees is the right basis, and seeing whether it goes up or down over a number of years by taking snapshot looks, say, every 3 years.

Senator BINGAMAN. I gather some of the objections that have been raised by some firms is that this would require disclosure of proprietary information, of their internal cost structures, and those types of things that they are not now giving out to people. What is your reaction?

Mr. BOWSHER. We do not believe that is a major problem because they have actually been willing to do it in past profit studies, once they get some assurances that it will be held in some kind of a central group and not given out as individual company data. And we think that in our proposed plan, based really on how it has been done in past years, there are enough assurances built that the proprietary data would remain confidential.

What you are trying to achieve is an overall look at the defense and the major government contracting industry.

Senator BINGAMAN. Do you have any estimate as to the cost, either to the government or to the contractors doing business with the government, of this additional reporting, monitoring, and auditing activity?

Mr. BOWSHER. We have not made any cost estimates because at this point we only have our exposure draft out for comment. Whenever and if there is some system that is finally decided upon, why, I think maybe some estimates should be made at the time.

But I really do not think the data collection should be all that costly because the data is basically coming out of their own accounting system. In other words, the Defense Department and the Congress over the years have had certain requirements in place, like the cost accounting standards and the requirements for basic systems at the contractors and so these things are in place For the information to flow should not be a big task at all.

One of the things that we are trying to get is the same data flowing to the Defense Department that to a certain extent is flowing to the stockholders and other groups. One of the problems you have today is that you get too much individual reporting, and it is different data that is being reported. We would like to see the basic data in the system reported.

Senator BINGAMAN. Then I take it you are not suggesting that you would try to verify the information that is supplied by the contractors?

Mr. BOWSHER. No. We think that their own CPA firms can do the review along with their own management and check it out; and when it comes in, it would basically be accepted on that basis. There might be some checking by that central group, but I think it would be very limited.

Senator BINGAMAN. I guess I would like your reaction to the general concern that most of the problems we found in defense procurement, in particular, have not been in this category that you are dealing with. They have been in items put into overhead that should not have been, misbilling of expenses, those kinds of things. It is the 85 or 90 percent of the cost of the contract which is not profit that has been the main subject of abuse, at least in the examples that have been brought forward.

I am wondering if we are focusing on too narrow a band of the problem here with this suggestion.

Mr. BOWSHER. Well, I definitely agree with you that the 90 percent is the important percent. In other words, it is really the cost of producing these weapons that is important, and, therefore, you need all the other systems and all the other reviews that we put on that area.

And so I am not suggesting this as a substitution at all for looking at the 90 percent, you might say, or getting accurate reporting of the cost. But even after you have done that, there is always the question, are the contractors making too much or too little?

In fact, one of the reasons why you had these profit studies in the past is the defense industry said it was making too little. And so you have had profit studies done lots of times at their request to show the Defense Department and the Congress, that it really needed more profits, or a better return on their investment.

All I am saying is that I think we ought to do it periodically; we ought to do it on the same basis every time we take that snapshot; and we ought to do it in a more organized fashion than we have in the past.

It is really, as you say, to look at that one piece in a better fashion than it has in the past. It in no way would replace the concern and the review of the 90 percent which is the cost of producing the weapons.

Senator BINGAMAN. In your view, is that concern about the 90 percent being adequately addressed by the changes that have been made recently? Or do you see this extra 10 percent as the main unaddressed problem area at this time?

Mr. BOWSHER. No. No. I think it is just one of the unaddressed things. I think that some of the other problems in the systems for cost estimating, in the systems for dealing with their subcontractors, in the systems for how they allocate their overhead, and so forth, is every bit as important, and I think we have to continue to do reviews in those areas and report to Congress.

Senator BINGAMAN. OK. I think that is all I have, Mr. Chairman.

Chairman GLENN. Thank you.

Senator Sasser.

Senator SASSER. Thank you, Mr. Chairman. We have got enough microphones here. I am not sure which one to use.

Mr. Chairman, I want to commend you for scheduling these hearings here today. I think it is very appropriate that the first hearings of the Government Affairs Committee focus on the continuing problems of waste, fraud, and abuse of the Federal taxpayer's dollar. Let me add, I am delighted to return to the committee, Mr. Chairman, after a 2-year hiatus. I am particularly pleased to return to this committee under your leadership, I might say.

Chairman GLENN. Glad to have you aboard.

Senator SASSER. Mr. Bowsher, I got here when you had already begun your testimony, but I have read your statement with great interest. I heard you say something that I could hardly believe.

You indicated that the State Department thought you were too tough when you went down to audit where the humanitarian aid had gone because you asked them where the money went. Is that a correct assessment?

Mr. BOWSHER. That is right. In their official letters back to us—which are included in the report—they contend that we are holding this program to too high of a standard of accountability and auditing.

Senator SASSER. Simply because you asked them where the money went——

Mr. BOWSHER. Yes.

Senator SASSER [continuing]. The State Department claims you are holding too high——

Mr. BOWSHER. Comparing the payees on checks to the supporting documentation, that is not high tech auditing. That is basic auditing that we would do in any program, either in the private sector or in the government sector. It is nothing unusual.

Senator SASSER. Well, did they indicate why they thought you were down there if you did not come to Miami to find out where the money went? That is an astonishing statement, as far as I am concerned, that they would think they were being held to too high a degree of accountability because the General Accounting Office wanted to know where the $27 million in humanitarian aid was spent.

Were you able to determine what percent of the $27 million of humanitarian aid was actually spent for that purpose?

Mr. BOWSHER. Well, what we were able to determine—was it $9 million?

Mr. CONAHAN. About $9 million.

Mr. BOWSHER. About $9 million we felt we could account for fairly well, and that left close to $17 million that we really could not verify to the extent that we thought it should be verified.

Senator SASSER. So you could account for only one-third.

Mr. BOWSHER. That is about right.

Senator SASSER. To your satisfaction, only one-third of the $27 million that went for humanitarian aid.

Mr. BOWSHER. Yes. And I think if anybody reads that report, they will see some of the problems that have come out in the Iran-Contra affair, such as currency speculation, unusual payees, and money moving into unusual banks and offshore accounts.

The report was a warning about what were some of the potential problems, and yet people seemed not to want to take the warning. Instead, they fought the suggestions of the problems, more than to recognize and correct them.

Senator SASSER. You talked about unusual payees and unusual banks, were these funds moving into Swiss banks?

Mr. BOWSHER. Frank Conahan was in charge of our work. I will let him answer that question.

Mr. CONAHAN. We found payments from the accounts of the brokers who had received the humanitarian assistance funds. We found payments into banks in the Bahamas and the Cayman Islands. We saw payments to the military leaders of countries in the region.

These did not seem to be appropriate ultimate payees for the supplies that were allegedly delivered under the program. We questioned the State Department on these transactions. In the case of the offshore payments, they did not have any more access than we had at that point. My understanding is that the Federal Bureau of

Investigation still has an ongoing effort with respect to some of those payments.

The Department of State made the statement that the payments to the military in those areas were appropriate. They felt that they were simply reimbursements for certain supplies that had been provided. But they did not provide verification.

Chairman **Glenn**. There were payments out of the $27 million that you could track that went direct to heads of states of other countries not involved directly with the Contras?

Mr. **Conahan**. The Department of State took the position that they were involved in supplying the Contras.

Chairman **Glenn**. But no record of what they supplied?

Mr. **Conahan**. But no record of what they supplied.

What we had, Mr. Chairman, were invoices submitted by suppliers in the region, or alleged suppliers in the region. On the bases of receipts which those suppliers provided to the United Nicaraguan Opposition, the Department of State made a transfer of funds, usually by wire, to bank accounts in Miami—either directly to suppliers' accounts or to brokers for suppliers.

We were not able to trace payments out of the accounts to the actual suppliers. In the case of the suppliers themselves, we found payments to the military leaders of certain countries in the region.

Chairman **Glenn**. And no indication that it ever got spent for humanitarian aid. It is just in somebody else's bank account. Is that right?

Mr. **Conahan**. That is as far as the record goes.

Senator **Sasser**. That is a point well made, Mr. Chairman, and that is precisely what I was driving at. In other words, when you have a situation here where these funds are being paid to military leaders of other countries in Central America, but based on your investigation, you have no idea what purpose these funds were transferred for.

In other words, you found no receipts for humanitarian supplies—or military supplies, for that matter—to back up or substantiate these payments. Is that a fair statement?

Mr. **Conahan**. The only thing we have is the statement by the Department of State that these folks were involved in the supply.

Senator **Sasser**. So the Department of State was asking you to accept these disbursements at face value, and when you started asking them what the money was spent for, then they took the attitude that you, the General Accounting Office, was just simply being too tough.

Mr. **Conahan**. You will recall also, Senator, that when we pushed, they said that they did have some intelligence reports which gave them assurances that goods had been delivered.

We have never been able to see those. Some folks that have seen those contend that they do not give the assurances that the department contends they provide.

Senator **Sasser**. Well, gentlemen, the reason I ask you about this in some detail is the administration is going to be up here in a very few days to ask for the release of another $40 million to be spent in support of the Contras. There is some discussion that we may ask the administration to give us an accounting on how previous funds have been spent before this $40 million is released.

General Bowsher, your statement suggests, and you have also indicated orally today, that we need specific legislation to get a handle on what is done with the CIA's covert accounts.

Now, what specifically do you think you will need in the way of legislation to be able to track money in the CIA's covert accounts to get some accountability into the CIA's operations?

Here we have statements that checks were just written to the military leaders of Central American countries, and we have nothing to substantiate what we got for these funds.

How can we get some accountability of the CIA's operations in these matters?

Mr. BOWSHER. Well, I think what we would have to do is have our lawyers sit down with some of the lawyers of the CIA and some of your committee staff and work it through.

As I pointed out earlier in the hearing, we did this about 10 years ago with the IRS and the Federal Reserve System, and we were able to come up with legislation that clarified our access in those two institutions. And it has worked well.

I think, as I also pointed out earlier, there are probably some parts of the CIA operations that maybe we should not have access to. But there are large programs out there that the Congress might well want an external review of and then, as I also pointed out, maybe some special reporting of our findings.

Senator SASSER. General Bowsher, your statement also pays particular attention to some of the problems that are plaguing the Internal Revenue Service. Do you have any projections today as to just how much these IRS problems have cost the Federal government by way of lost revenues? And, conversely, do you think the difficulty that the IRS is experiencing in some of their procedures are adding to the number of Americans who are non-reporting, those who have sort of moved into the so-called underground economy?

Mr. BOWSHER. Well, I think that the IRS themselves have given an estimate of close to $100 billion that they feel is lost revenue, either people not reporting it at all or people under-reporting.

Senator SASSER. $100 billion a year lost by way of failing to report or underreport. Mr. Chairman, that is the solution to our deficit problem right there if we can work that out.

Mr. BOWSHER. Yes. As far as their systems go, again, their systems are basically 1950 vintage. In other words, they are tape drive computer systems, but a lot of their manual systems go back a good many years, and what they are doing is converting some of those systems from time to time to new equipment, and in 1985, as everyone is aware, that conversion had trouble, and that is always a potential problem here as you make some of these conversions.

I think one of the real problems with the overall procedures though is that you have not had a real modernization of that system for many, many years, and you have a code which has become extremely complex. You have business and individual returns today that are sent into the IRS which are awfully complicated for people to review, therefore very time consuming, therefore a lower percentage of the returns are reviewed previously.

So this all adds up, I think, to a concern that I think the Congress must have as to how will this all work out in, say, the next decade.

Now, we are in the midst right now of doing a complete management review of the IRS department. I think later in the year we will have that completed. The new commissioner, Gibbs, has given us excellent cooperation and is anxious to have the review done. And so I am hoping that when we have that work completed and can issue that report that it will be helpful both to him, as the director of the agency, but also to the Congress.

I think what you might need is some investments in some more modern approaches and systems in collecting our taxes.

Senator **Sasser**. Thank you, General Bowsher, my time is up.

Chairman **Glenn**. Thank you, Senator Sasser. Senator Heinz.

Senator **Heinz**. Mr. Chairman, thank you. First I would ask unanimous consent that my statement be put in the record.

Chairman **Glenn**. Without objection.

OPENING STATEMENT OF SENATOR HEINZ

Senator **Heinz**. I would like to just say that it is a pleasure to be back on this committee, to continue serving with you and we worked on the Aging Committee a number of years, and it is a pleasure to welcome our Comptroller General to the committee to congratulate him on a sweeping and excellent statement.

[Senator Heinz' prepared statement follows:]

Prepared Statement of Senator Heinz

Mr. Chairman, I am very pleased to see the Comptroller General with us today, and I would like to commend the Chairman for holding this hearing. The accountability of Federal agencies to the GAO is essential if Congress is to carry out its over-sight functions. This is true in open accounts, as well as classified accounts. Restrictions which prevent the GAO from honoring Congress' requests for audits represent a threat to the orderly management of the Federal government.

Obviously, GAO's inability to audit CIA accounts is now well known in light of recent revelations of activities in Central America and the Middle East. The CIA's non-cooperation is particularly questionable given GAO's access to NSA accounts and very secret military operations, the so-called black programs.

As usual, the Comptroller General's statement is far-reaching, and takes the broad approach. The need for budget reform, and particularly credit reform within the budget, cries out for our attention. In addition, greater accountability in procurement, farm credit management, IRS and many more deserve our attention.

I have a particular concern over IRS management. As the Comptroller General knows all too well, the Philadelphia IRS Center experienced near total collapse in 1985. While major improvements have been made there, the information you have supplied us today indicates that the problem has not been fully corrected, such as the absence of agency-wide management systems, and inadequate computer capacity. A second disaster at the IRS would not only help undermine public confidence in Federal management, but would cost millions and probably billions in lost revenue.

Failure of the Social Security Administration to upgrade its computer services—where errors literally deprive older Americans of earned benefits—desperately needs attention. Here again, the Comptroller General has addressed a critical need, and one which I hope the Committee will address in the near future.

I would only add that we are seeing similar failures to utilize available automation in AFDC and the Department of Labor. Only a handful of states have implemented AFDC automation, while the Department of Health and Human Services continues to pay 90 percent of the costs to install these systems. Many states simply draw down funds indefinitely. At the Department of Labor, state employment security offices have not received assistance in automating job search and relocation services, and are frequently unable to match potential workers with potential jobs because of a lack of computerization.

In sum, Mr. Chairman, I commend Mr. Bowsher for presenting us with timely and significant testimony, and I look forward to acting upon his recommendations.

Senator HEINZ. There is a lot I could ask about. Senator Sasser touched on one that is of more than parochial interest to me when he talked about the Internal Revenue Service. You mentioned earlier in your statement that the IRS might not have the internal management to properly use the additional resources proposed in the administration budget. My question to you is does it follow, then, that the administration's revenue assumptions, some of which can be questioned, and which result from increased IRS compliance, are also faulty?

Mr. BOWSHER. Well, our people who specialize in this area have reviewed those figures and, by and large, they think the figures are in the ballpark. They really do.

Senator HEINZ. You also mentioned that the computer capacity at the IRS is badly strained. How far are we from another IRS disaster such as the one we had about two years ago at the Philadelphia Regional Service Center of the IRS?

Mr. BOWSHER. Yes. That is hard to predict, Senator, because I think the risks come when you convert those systems. And any time they convert to new equipment, with those tape drive systems that they have, why, you are going to be taking some risk in that.

Right now they feel confident, as I am sure they have testified before you, that they are on top of it. But I think that any time that you have those older systems, and you are moving tapes around, one thing that is interesting and goes back to a question that Senator Roth raised too, and that is the Treasury system.

In other words, when somebody is given a refund—let's say they are up in the Boston area and they file their tax return with the service center up there, that goes into that service center; that gets onto that tape; that tape has to be moved down here to the central processing group in West Virginia. And then to cut a check they have to actually move another tape up to Philadelphia.

As you know, in this day and age, transporting tapes around the country is pretty old fashioned.

Senator HEINZ. As you know—as your agency knows because you did an excellent audit, not only of the Philadelphia service center but the procedures nationwide, and I commend you and your staff for that excellent work—shipping tapes around is not only antiquated but the tracking procedure for making sure that the tapes that were shipped were actually received and fully accounted for was tremendously faulty. It took the IRS something like 4 months to realize they had lost an entire tape with all the payments by employers for their employees. Is that likely to happen again.

Mr. BOWSHER. I think it has the potential of happening again. Whether that will happen or is likely is hard to predict.

Senator HEINZ. Let me go to a slightly broader question. In your statement you mentioned the speech you gave yesterday in San Francisco.

Mr. BOWSHER. That is right.

Senator HEINZ. I wasn't there to hear your speech, but I got a copy of it, and you say some very interesting things and I would like to ask you about them. One of the things you say is that the defense program must not be gutted. I salute you for that, for saying that—we should not. But you also say but neither can we continue the pace of the past seven years. The Defense Department cannot manage, you say, that rate of growth efficiently, and the public will not support it.

Now, first question: The administration is coming in for an increase in budget authority from about $292 billion to $312 billion—a $20 billion increase. Is that $20 billion on top of what has been authorized for the Defense Department? Is that too much money? Can they spend that money efficiently, or not?

Mr. **Bowsher**. Well, it's hard to say on an increment of $20 billion. What I was really pointing out in my speech was that we doubled the size of the defense budget in about 4 or 5 years, and in doing our work in that 4 or 5 years we saw all kinds of illustrations of where they really didn't have the systems or people to stay on top of how that money was being spent.

And, in fact, one time when Frank and I were in Europe, checking out some of the military installations over there, a Lieutenant Colonel described it well. And that is, he said, we had not had any construction here for a number of years. All of a sudden the money flowed in great quantity and the money had to be placed on contract in a matter of months. We didn't have the civil engineers who were needed to make sure that that money was spent wisely and efficiently.

When we look at the inventories that have grown dramatically in the warehouses we see the lack of physical and financial controls over the inventories. We worry about that. We have seen the spare parts problems. We have seen the problems with programs like the B-1 bomber and the Bradley and some of the others where there has not been adequate testing. And so those are the problems that I worry about and we report on constantly. Those kinds of problems are magnified when you double a $140 to $150 billion budget in 4 or 5 years.

Senator **Heinz**. Let me follow up with you on that. You have proposed in your statement a number of changes, and presumably the additional information that you would provide would give the Congress both its authorizing and appropriating committees better management tools so that when either the Armed Services Committee or the Defense subcommittees of appropriations made recommendations to us all, that they will be able to evaluate much better than heretofore whether we are just throwing money at a problem and not solving it, or whether the money is being prudently spent. Is that a realistic expectation that what you propose, in your rather sweeping and, to my mind, very commonsensical changes, that Congress, and for that matter the Defense Department, will be able to do a better job than has been done so far?

Mr. **Bowsher**. Yes. What we are proposing is that they have an accounting system over at the Defense Department that could actually account for the funds by, say, major weapons. Right now you have a totally separate system called the SAR system that gives you periodic information, but it is not tied to the books of account. A lot of the information is now obtained by calling the prime contractor and asking for it.

Senator HEINZ. But how is that going to help the kind of problem you just described where suddenly someone in our NATO installation says "Quick, build a warehouse, and get the money committed in the next 2 months, otherwise you might not get it."

Mr. BOWSHER. Yes. It seems to me that an accounting system and a financial reporting system where everybody has the same numbers and can look at how the money is being spent would be very helpful. One of the things that happens with the Defense budget is there is a lot of time and money being spent on looking at the budget. It is done at Defense all through the year, then it comes over to OMB, and then it comes over to the Congress. Then the money is appropriated. Then it is spent. At that point there is very little accounting to decision makers because the books are months and months late. And so what we are saying is there should be an accounting system that can be up to date as to how money is being spent against the Congressionally approved budget.

Senator HEINZ. So it won't necessarily result in better budgeting?

Mr. BOWSHER. It would be better information for the decision makers, as they work with the budget. It does not insure good decision making. That's correct.

Senator HEINZ. One of the other things you said in your speech yesterday had to do with finding a way to restrain the growth of Social Security and cost-of-living payments under that. Now, that made me reflect on the fact that the Social Security system of the old age and survivors trust funds are now segregated from budget. And it is not clear to me why doing anything with Social Security, which is segregated, and which has to build up surpluses against for the benefit of the baby boom generation that will start retiring around 2015, why anything we do that saves money in the social security system will, in fact, be anything at all about the structural budget deficit problem we have.

Mr. BOWSHER. The main point I was pointing out there, Senator, in trying to answer the question which I get many times, is how did we get into such a large deficit and so much debt. And I trace it right back, that one of the beginning places was in the early 1970's when we indexed all these programs. And I point out that in the late 1970's, that Congress and many of the people who voted for that automatic cost-of-living adjustments on these major programs did not do so expecting such high inflation years. We now have the inflation down, which is a very positive accomplishment. But we still have the mechanism in our budgetary process that if we run into higher inflation years, those budget amounts are going to jump right up there again on all the programs where you have 100 percent cost-of-living adjustments there. And I just think it is an area that Congress ought to take a look at.

Senator HEINZ. That may well be but——

Mr. BOWSHER. And now, I come to your Social Security question. And that is that last year we had a budget deficit of $221 billion—the largest ever. The truth of the matter is, if you took out the Social Security net positive cash flow we had a budget deficit of maybe closer to $290 billion. And so you are absolutely right, the cash——

Senator HEINZ. Social Security had about a $30 billion surplus last year—about $250.

Mr. **Bowsher**. Yes. And you had also other plusses there, in some of the programs, and you had some of your capital items and things like that. So, what we say is if you put the Federal government on the same accounting as what you do on say the State and local governments of this country, it might come closer to $290 billion. And so you are right that the Social Security is separate, but it does have a big influence on your unified budget concept, and the cash flow and the financing of the Federal government.

Senator **Heinz**. Mr. Chairman, my time has expired. If I might continue about 30 seconds just to finish this point and then I promise to be good.

You have hit the nail on the head because if you look at any of the projections on anybody's budgets, whether it is CBO, whether it is OMB current services, whether it is the President's budget, and whether it is going to be a $61 billion deficit projected under Gramm-Rudman-Hollings, or as CBO thinks we will have in 1988, or 0 as the administration thinks, or $42 billion under OMB current services approach, the fact is that the budget deficits, in terms of structure, are not anything close to that low. They are $40, $50, or $60 billion a year higher depending on your assumptions. And what they mean is that we will have a real budget deficit this year of anywhere from a low estimate—under the administration's number it would be $147 billion; the high estimate, which would be CBO, would be $205, and the worst part about that is that those will not be the numbers we are looking at. And as Social Security's surpluses grow, the structural budget deficit is going to grow even bigger because we will use that—the Social Security surpluses—as a pain killer, to keep us from having to make any painful decisions of the kind that you are saying that we ought to make.

I thank you for pointing that out because I think we are drugging ourselves on social security valium here, and it worries me greatly that we are going to wake up from going to sleep for 20 years, having taken an overdose of valium and finding, my goodness, the budget deficit was not $100 billion, was not $90 billion. It really was $200, $300, or $400 billion. And that is when the going really gets tough.

Mr. **Bowsher**. I agree with you Senator very much, and that was one of the purposes of my speech there yesterday in San Francisco. It was to try to alert the people to the fact that this budget deficit really is more serious than even the numbers that we are looking at.

Senator **Heinz**. Keep it up.

Mr. **Bowsher**. Yes.

Senator **Heinz**. Mr. Chairman, thank you.

Chairman **Glenn**. Thank you, John. Back to the subject of humanitarian aid to the Contras. Do you have any indication that any of that so-called humanitarian aid went for weapons?

Mr. **Bowsher**. Well, when we pushed on the documentation, the State Department did some checking themselves and found some instances there where it went for ammunition and grenades. They pulled that money back.

Chairman **Glenn**. What kind of weapons were purchased and how much were they worth out of that $27 million?

Mr. **Bowsher**. It wasn't large.

Mr. CONAHAN. The Department identified questionable payments amounting to about $80,000. Some of it was for small arms, and grenades. The Department said that they were isolated cases, but neither we nor they, I believe, are in a position to make that claim.

Mr. BOWSHER. And if I could just add to that, Mr. Chairman, it seems to me on a program like this, if you have adequate controls, that just should not happen.

Chairman GLENN. I could not agree with you more. There has been some question about Philippine aid. Do you have any comments on that: what you were able to track, what went into the Philippines, and what it was used for?

Mr. BOWSHER. Yes. What we found in the Philippines, and what worries us about some of the other programs is that the monies are going into the central banks of these other countries and they are being comingled, and at that point in time you do not know how that money is being used. And so, we just think it is an area that the Congress ought to give a good deal of thought to, as to some of these problems where we are making large cash transfers literally into the central bank of other countries.

Chairman GLENN. Do we have any indication, or can you tell us of any indication that any of the money into the Philippines actually went into personal bank accounts?

Mr. BOWSHER. We tried to track that down, but once it gets comingled it is very, very hard to track.

Chairman GLENN. Do we have any countries where we are adequately monitoring exactly what the money is used for? Are there any systems in existence where there are exemplary accounting systems where we know exactly what the money is being used for?

Mr. CONAHAN. Several years ago we took a look at the cash transfers into Central America, into Honduras and El Salvador, and found an absence of any sort of control into those funds. As a result of that, legislation was enacted which required segregated accounts for the cash transfers into El Salvador. The El Salvadoran government, working with the Agency for International Development, has hired a big eight accounting firm to put a system in. We have taken a preliminary look at it, and it looks pretty good, and could very well serve as a model for future control systems.

Indeed, the legislation last year requires that certain economic support fund cash transfers, beginning this month, be covered by a separate account.

Chairman GLENN. Is this inability of the State Department to track these funds—are these sins of omission or commission? Is this a deliberate effort not to track the money? It just seems to me so fundamental that we would have a track of what the money is spent for, that I cannot believe that we would not be setting that up right along with the use of this money so we could prove where it went. Is this just an omission, a failure to set up a system, or what?

Mr. CONAHAN. I think that the basic legislation gives the President flexibility in the terms and conditions under which these kinds of funds are being provided.

Chairman GLENN. Well, it cannot be much more flexible than that—that they just float money off into somebody else's account.

Mr. Conahan. That is right. I think that over the past several years that we found that they have backed away from any sort of control, and the disclosure has now raised a lot of concern, not only in the Congress, but some folks in the administration now are willing to talk about controls.

Mr. Bowsher. I think another aspect of it too, Mr. Chairman, is that any country that can get this arrangement, likes it. And when they see other countries that have the arrangement, they then put a lot of pressure to get it for their country. And so, I think what you have got here is something that got started some years back that needs a very hard look.

Chairman Glenn. I know an awful low of people in Ohio would like to have an arrangement like that too.

Mr. Conahan. I think there are two sides to this too. There is not only the cash transfers, the U.S. dollars that go over, but there is frequently a requirement that the recipient come up with its own local currency for purposes of funding economic development projects and other activity in their country, and the controls there are sorely lacking as well. And we have found instances where there were inappropriate uses of those funds.

Chairman Glenn. Should we require, as part of giving aid, that the recipeint country have adequate records to account for it. Isn't that just fundamental?

Mr. Conahan. Yes, sir, I think we should, and we've made recommendations both in terms of the dollars as well as the local currencies.

Chairman Glenn. Can you tell me which countries seem to pose the biggest problem in not being able to follow how they use the money?

Mr. Conahan. The programs that we have reported on over the past several years were Honduras, El Salvador, the Philippines, and several African countries.

Chairman Glenn. Were there were no controls or were they lacking in controls?

Mr. Conahan. Where they were very much lacking in controls.

Mr. Bowsher. I think we could provide for the record, Mr. Chairman, if you would like, the countries and the programs and the dollars that are involved in the these types of arrangements.

[The information referred to follows:]

ESF CASH TRANSFER RECIPIENTS
(millions)

	FY 1986 (Actual)	FY1987 1/ (est.)	FY 1988 (Proposed)
AFRICA			
Chad	$7.000	-	$5.000
Djibouti	-	3.552	3.000
Guinea	10.000	-	-
Liberia	28.203	40.000	17.000
Niger	4.373	7.000	-
Senegal	26.484	15.000	14.000
Somalia	21.011	-	22.000
Togo	7.850	-	-
Zambia	17.000	-	-
Regional programs	-	75.000	-
ASIA, NEAR EAST, AND EUROPE			
Cambodian Resistance	-	-	5.000
Philippines	219.625	47.500	74.000
Thailand	5.000	5.000	5.000
Regional programs	7.000	-	9.000
Egypt	110.055	115.000	115.000
Israel	1148.400	1,200.000	1,200.000
Ireland	50.000	-	35.000
Portugal	76.487	80.000	80.000
Turkey	119.625	150.000	125.000
LATIN AMERICA AND THE CARIBBEAN			
Belize	1.500	3.000	1.350
Bolivia	7.177	20.000	30.000
Costa Rica	120.582	150.000	85.500
Dominican Republic	40.000	50.000	35.000
Ecuador	20.110	15.000	17.000
El Salvador	147.000	207.000	164.500
Guatemala	47.350	70.000	74.500
Haiti	18.000	-	25.000
Honduras	61.248	90.000	93.500
Jamaica	58.000	100.000	45.000
Panama	5.742	28.000	5.557
Peru	-	36.000	-
Uruguay	14.000	15.000	-
Regional programs	9.500	10.000	20.400
TOTAL	$2,408.322	$2,532.052	$2,306.307

1/Does not include proposed FY 1987 Supplemental.

Chairman **Glenn**. Thank you. Have you completed your investigation of the money track in the Iran-Contra affair?

Mr. **Bowsher**. No, we have not. We are still working on that. We have pretty much completed our work on tracking the movement of the arms, and we are ready to come forward very soon with testimony and a report to the select committees on that. Regarding tracking the money, that has been done more with the FBI, who is working for the special prosecutor. We are working the select committees to determine what they want us to do in that area.

Chairman **Glenn**. You have not been able to determine where all the money went after Iran paid for the arms?

Mr. **Bowsher**. No, we have not.

Chairman **Glenn**. Back to the subject of humanitarian aid to the Contras. I'm hung up on that one a little bit, I guess. Do you believe that there was a violation of the law?

Mr. **Bowsher**. The FBI is investigating certain aspects of that program. We are waiting to see what they and the Justice Department conclude.

Chairman **Glenn**. I don't know if you answered exactly whether this was a sin of omission or commission by the State Department.

Mr. **Conahan**. The State Department's Nicaraguan Humanitarian Assistance Office initially wanted to establish some sort of operation or mechanism in the countries of the region, but they determined that because of the sensitivities in the region they could not do that. So, practically, from the outset, in the absence of having something on the ground to track the aid they weren't able to fulfill the statute which called upon them to ensure that these funds were not diverted for other than humanitarian purposes.

Chairman **Glenn**. Do they have an accounting system in the State Department that could do this if the country did agree?

Mr. **Bowsher**. I do not think there is any reason why they should not be able to. Their accounting systems and controls, should be able to account for it.

Chairman **Glenn**. Well, I just think we have to require that unless this is carried out, we just do not send any money—the money does not get transferred unless there are adequate systems, right in place, to monitor exactly what it is being used for. Obviously, we have been playing pretty fast and loose with taxpayer dollars in some of these areas.

In a different area. You say we have 450 individual accounting systems, and our entire system is old and in bad shape, to quote your own words here. Do you have any estimate of what the cost would be of overhauling our accounting system government-wide, if we were to set up an optimum system that you would be adequate to really monitor what goes on with taxpayer money?

Mr. **Bowsher**. We do not, because we don't have any agreement on the new system that should be put in place. When we issued our report here 2 years ago on managing the cost of government, we put forward a conceptual design that we thought would make some sense, and what is really built on the systems that have been used by some of the states and the larger cities that have modernized their systems in the last few years.

I might point out that we are spending literally hundreds of millions of dollars on those 450 systems. In other words, Fred Wolf here on my right is in charge of our reviews of the various accounting systems in the Federal government, and so we are spending an awful lot of money just keeping those systems together—kind of like the IRS systems.

And what I feel very strongly about is that the administration and the executive branch ought to develop an overall conceptual design, ought to get some modern systems in, say, 20 of the largest departments which comprise 95 percent of the Federal budget, and really spend our monies to the point we have some control and timely reporting after spending these large sums of money, rather than just continuing to band-aid or computerize some of old systems, which is currently what we are doing.

Chairman **Glenn**. There is no effort being made now to eliminate these or combine systems into one new accounting type system?

Mr. **Bowsher**. There is some effort. Fred, if you would like to pick up there and just kind of explain—but they are fairly limited at this point in time. We are encouraged, I will point this out, that the Treasury Department finally went along with us a few months ago, and have issued standard statements that each agency has to report on, which is what we called for when we revised our accounting standards, and Mr. Miller, the new director of OMB, and Mr. Baker and myself signed a letter to all the agencies saying to get on and improve their existing systems. This was something we could not get OMB, under David Stockman, to do, and we have been able to get the new leadership over there to go along with us, but it is not getting to what I call the big issue, and that is some modern systems that control the big dollars in the Federal government in these major agencies. That is what we have got to achieve.

Fred, do you want to amplify anything.

Mr. **Wolf**. I guess the only thing I would add is, until you really get to the point where you require some overall financial statements and some financial audit like we have seen in most of the States, you are going to continue to have problems with accountability, and with not very good systems. That is sort of the capstone of what is needed to get some of this stuff under control.

Chairman **Glenn**. Do we need to expand the Inspector General system.

Mr. **Bowsher**. I think certain IG's are probably understaffed, but I think, on balance, the IG group is doing well and doing what the Congress hoped they would be able to do when they were created. And so, I would look at some of the ones—I think NASA is one that comes to my mind, has a fairly limited staff—but I think, on balance, they are doing quite well.

Chairman **Glenn**. Do we need to move IG's into more agencies?

Mr. **Bowsher**. I think there are a couple of agencies still that should have—I think Treasury is one and Justice is the other—the two major ones.

Chairman **Glenn**. You have addressed, to some extent, the problems in the military, and where some of our problems lie there—defense contractors and so on. How about inventory management? Is that a significant problem?

Mr. **Bowsher**. That is a very significant problem. We have issued some reports in the last year that I find very scary. There were reports that came out of the thievery that was going on at the Navy in San Diego, where people were actually looking at the systems and picking out the parts, and stealing them and sending them over to places like Iran.

Senator Wilson and others asked us to do additional work.[1] Fort Bragg, we found some very potent weapons being stolen, and others have reported these getting into the hands of some extreme groups. And so, I think it is a serious situation from loss of funds, you might say, and scary where some of these explosives may be ending up.

Chairman GLENN. If you had to make an estimate, what would you say is the inventory of specific missiles—of Stingers or TOW's, or whatever we have out there? Are we within 1 or 2 percent of what we think we have, or can we pin it down that well, or would we be lucky to say we are off by a third? What would be your estimate on these different areas?

Mr. CONAHAN. The Air Force currently believes that its inventory record accuracy is somewhere around 68 or 69 percent, across the board. If you want to extrapolate——

Chairman GLENN. You mean there is a third of our inventory that we do not know whether is there or not?

Mr. CONAHAN. That is correct. When they take annual actual inventories and compare it with the inventory records they find that kind of a discrepancy.

Chairman GLENN. That a third may be missing?

Mr. CONAHAN. We just are not able to determine where it is. It may or may not be missing, but the records are not——

Chairman GLENN. That would not apply to airplanes, for instance, but it might apply to weapons?

Mr. CONAHAN. We are talking about spare parts and ordnance and ammunition, this sort of thing.

Chairman GLENN. Missiles, Stingers, ammunition, that sort of thing?

Mr. CONAHAN. Yes, sir.

[Subsequent to the hearing Mr. Conahan added the following: Some ammunition, explosives, spare parts, and so forth, but probably not sophisticated munitions that are serial-number controlled.]

Chairman GLENN. May be off by as much as a third?

Mr. CONAHAN. It may be off by as much as a third.

Chairman GLENN. Those are the Air Force's own figures, not your figures?

Mr. CONAHAN. That is the Air Force figure, yes, sir.

Chairman GLENN. So we may have a third less ammunition, a third less missiles, a third less whatever we are going to shoot, that we think is out there to provide security—a third of it might not be there?

Mr. CONAHAN. I do not want to sound flip on this but we might have a third more as well. It is simply that the inventory records, when they take them annually, are inaccurate to that extent.

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[1] See p. 110 for ongoing assignments started at the request of Senator Pete Wilson.

Chairman **Glenn**. Our contact is so poor that we cannot tell, within a third, whether we have it or do not have it? It could be a third more than we think we have?

Mr. **Conahan**. In some instances we start off before adjustments where the records are as much as two-thirds off, and then through reconciliation we can get it down to that figure. The Air Force standard is 85 percent. The DOD-wide standard is 85 percent.

Chairman **Glenn**. How about the other services?

Mr. **Conahan**. 85 percent is the standard.

Chairman **Glenn**. For the Air Force?

Mr. **Conahan**. No, for DOD. I do not have figures for other than the Air Force, and where they actually stand at the moment.

Chairman **Glenn**. Well, do the others not even have systems that can even give it within one-third then?

Mr. **Conahan**. I do not have that number, but they have similar problems as the Air Force.

Mr. **Bowsher**. One of the problems I think we have, Mr. Chairman, and one that we have tried to highlight in this conceptual design of a new system for the government is that you, lots of times, do not have financial control over your larger inventory items. You just have so-called physical control, and that is because you have already paid for them through the budget. But like in industry, or other units a lot of times, you are trying to track how much dollars you have got in your inventory as well as what the quantity is in there, and lots of times if you do that on your major items you generally have a better result.

Chairman **Glenn**. The thing that bothers me too, is the fact, obviously, if there is a possibility that a lot of things are being stolen, will they end up in the hands of terrorists?

Mr. **Bowsher**. That is what really scares me when I see these reports that we issued this past year on some of the inventory shortages, especially ammunition and explosives. Senator Wilson held a hearing last fall where Federal criminal investigators and law enforcement officials discussed where some of these items could be going. It is very scary.

Mr. **Conahan**. Another important aspect is that defense contractors have rather direct access to the military supply systems. We now have a body of work under way for Senator Wilson where we are identifying problems when the defense contractors access those supplies.

We found that often, rather than inventoring the items, they expense it directly and there is a complete loss of any sort of accountability right from the outset.

Chairman **Glenn**. Well, through DOD, is there no effort made to keep a central inventory of ammunition and missiles and such so that you can tap into that and know exactly what our condition is at any one time? If one is used in training or something, then that is marked off and reported and so on? There is no centralized system like that?

Mr. **Conahan**. There are systems which were initially designed to achieve the kind of accountability that you are talking about, but, as Mr. Bowsher stated, many of those systems are outdated; we find that the procedures are not being complied with; we find that because individual soldiers and commanders find the procedures onerous, they simply avoid them. There is a host of reasons why our inventory management is in the condition it's in today.

Chairman GLENN. Do we have any indication that some of this missing inventory winds up in the hands of terrorists or is being sold on the international arms market? Have you been able to track it that far?

Mr. CONAHAN. Well, the Treasury Department has tracked it; we have not done it independently, but I believe the Treasury Department has done it, and that there are individual court cases which clearly show that that is occurring.

Chairman GLENN. You mentioned earlier when we were talking about the Contra humanitarian aid—I believe it was in connection with that—you mentioned in passing that there was indication of taking some of the funds and doing currency speculation and unusual payees and accounts in the Bahamas and the Cayman Islands, I believe.

Mr. BOWSHER. That's correct.

Chairman GLENN. Could you elaborate on that?

What accounts were being used for currency speculation, who was doing it, what were the results of the speculation, who wound up with the money, who were the unusual payees?

Mr. CONAHAN. The Department of State was making payments to the suppliers and to the brokers on the basis of official exchange rates. The brokers and the suppliers were dealing at different exchange rates, for example, the rate prevailing in Miami. We found that some of these accounts had made profits of as much as 30 to 35 percent.

Chairman GLENN. The money went to whom?

Mr. CONAHAN. It was either retained by the brokers and suppliers or it may have been transferred out to other broker accounts. As I said earlier, we can see the payees out of these broker accounts, but we can't trace disbursements beyond that. We have names and we have banks and we have bank account numbers.

Chairman GLENN. In other words, they are investing with American money and taking the profits, but using the basic allotment for whatever purpose it was supposed to be used for. Meanwhile, they made a lot of money off it while they had it in the account, is that correct?

Mr. CONAHAN. That's correct. They made money and they also had profits which they could use for whatever purposes they chose.

Chairman GLENN. Was this with part of the $27 million?

Mr. CONAHAN. Yes, sir.

Mr. BOWSHER. Yes.

Chairman GLENN. It was, and you could track it that far where they actually did currency speculation with it, made a profit off of that while it was in their account?

Mr. BOWSHER. And we included that in our report.

Chairman GLENN. And how about the unusual payees? That's what you referred to just now.

Mr. CONAHAN. As I said, there were numbered bank accounts in the Cayman Islands and in the Bahamas. The Department of State had invoices which were purportedly submitted by the suppliers of goods. These were ordinary business invoices which would show boots and foodstuffs and pharmaceuticals and whatever. We expected that we would be able to trace payments from the State Department in approximately the same amounts to these suppliers in the regions. We were not able to do that. What we did is we found some payments from the State Department directly to the suppliers, and we found payments from the State Department to brokers. These brokers' accounts in turn did not disburse money to the suppliers; they disbursed it to other payees in the United States or other places such as the Cayman Islands. We also found payments to the military of the one country in the region.

There was not a direct relationship between the documents purportedly supporting the supplies and the payments.

Chairman GLENN. And from what you said previously, something labelled "boots" may actually have gone for grenades.

Mr. CONAHAN. We had no way of verifying that, nor do we believe the State Department had an adequate system to verify that either.

Chairman GLENN. You indicated before, though, that there was at least some $80,000 you tracked that went into grenades or for munitions of one kind or another that was supposed to be for humanitarian aid.

Mr. CONAHAN. Yes, sir.

Chairman GLENN. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman. I have a couple of questions. First of all, on the Gramm-Rudman deficit reduction approach, can you give us your opinion on the Senate amendment we adopted last year to fix Gramm-Rudman? Do you support that fix?

Mr. BOWSHER. That was the Senate amendment to—there were so many plans there, I don't quite remember.

Senator LEVIN. Well, after the Supreme Court ruled against us, we fixed Gramm-Rudman—we empowered the OMB, instead of the GAO to determine the final magnitude and distribution of spending cuts which would be required to meet the target. There were a lot of technical aspects to the Senate fix, which I'm not so interested in. I want to know whether or not you've taken a position on that particular fix.

Mr. BOWSHER. Yes, we did take a position, Senator Levin, that we thought it was better to use the fall-back position, for the Congress to vote it and not to put that fix in place.

Senator LEVIN. Did you or your legal people make a study as to the constitutionality of that fix.

Mr. BOWSHER. We were worried about the constitutionality—I'll have Milt, our lawyer here, amplify on that answer—but one of the concerns we had about the various fixes that were being considered at that time is we thought it could just put the whole process back into the courts. And so we were worried about it.

Senator LEVIN. Excuse me for interrupting. Was there a written opinion at that time?

Mr. BOWSHER. No.

Senator LEVIN. Has there been one since?

Mr. BOWSHER. No.

Senator LEVIN. Let me just leave it at that point, if you would. In your speech in San Francisco, you made reference to the decision of Congress to raise money for deficit reduction through the sale of loan assets, and then you said that this would actually make the problem worse next year because of the loss of future income. You said: "This effect might be compounded by the way the administration has planned to conduct the sales."

Would you elaborate on that? How are they planning to make these sales and how would it make the problem worse?

Mr. **Bowsher**. Our main concern was that they wanted to make all the sales without recourse, is the way the term goes. And what that means is, of course, that the government has no liability in the future. Now, what you have with these government loans is a real mixture; in other words, some of them are in pretty good shape and some of them are in pretty bad shape. And so what we were pointing out to the Congress when we testified last September was that if you take all recourse away, why that means that the private sector is probably going to discount the proceeds that they are willing to pay for these government loans, and therefore you will be giving up a lot of assets for maybe a relatively small amount of money.

Now, this varies by the type of loan and the package and the portfolios that were being put together, but it was a concern that we thought was a rigid approach that might well end up with not receiving as much money for them, if you went forward with a loan sale.

Senator **Levin**. Well, the administration is going forward with them, are they not, for the 1987 budget?

Mr. **Bowsher**. They are, that's correct.

Senator **Levin**. Have you made your concerns known to the administration?

Mr. **Bowsher**. Oh, very much so.

Senator **Levin**. And what's their reaction?

Mr. **Bowsher**. Well, they feel that they want to get a subsidy estimate so that they will know how much are these loans really worth, and they feel very strongly that if they put in any package with some kind of recourse that clouds up their ability to determine what the real subsidy is.

So they feel very strong about that, and we feel that, you know, that's an issue to be considered, but it's going to force you into getting less money for your assets.

Senator **Levin**. Do you know what the figure is for loan sales in the 1988 budget?

Mr. **Bowsher**. Offhand I don't, but we could certainly supply that for the record.

[Information subsequently supplied by Mr. Bowsher: The sales program includes loans with a fair value of $11.2 billion in 1988, which are estimated to produce offsetting receipts of $5.3 billion.]

Senator **Levin**. Do you oppose our adopting the sale of loan assets in the budget?

Mr. **Bowsher**. No.

Senator **Levin**. Or just how we compute the value of them?

Mr. **Bowsher**. No, we have two concerns basically: one is that if you do loan sales—and I think there is some merit in doing loan sales from time to time—why it should be done to maximize, you might say, the return on your asset for the American taxpayer; the second point that we have a lot of concern about is that you haven't had the systems in place to keep the documentation in good shape, and therefore, when you go out to pass what I would call this messy paper over to the private sector, again you are going to get deep discounting versus if you could give them good paper and good documentation and everything like that.

So those were our two main concerns.

Senator LEVIN. All right, now, you said that this would actually make the problem worse next year because of the loss of future income.

What did you mean by that?

Mr. BOWSHER. Well you normally would be getting a stream of income coming from your loans, and what you are doing is you are giving up that stream of income when you sell the asset itself.

Senator LEVIN. Isn't it something like selling future tax receipts?

Mr. BOWSHER. It's somewhat like that, yes.

Senator LEVIN. And aren't you really cautioning us on doing this because we are thereby digging ourselves a deeper hole for the future?

Mr. BOWSHER. That's exactly right, Senator, because what we are saying here is that the Gramm-Rudman process was as 5-year process to get down to zero or near zero on a balanced budget. If we do these kinds of things—and the other thing that upsets us a great deal is like moving payrolls from one fiscal year to another to help meet the target for a single year—in the long run you are not helping to achieve what the whole process is all about.

Senator LEVIN. We are digging ourselves a deeper hole by the sale of loan assets this year, instead of getting a stream of income later, by taking it all now, and cashing it in now. We also digging ourselves a deeper hole to some extent by providing recourse on the loans since the government will have to, in effect, pay off those loans in future years?

Mr. BOWSHER. Well, each of those portfolios has to be looked at, I think, and there's no question that we have a lot of loan guarantees and a lot of things out there that we might well have to pay off in a future year. I think a good example is the maritime program; in other words, we are paying off now hard taxpayer dollars on loan guarantees, recourse, that were programs of some——

Senator LEVIN. My question is, though, to simply say we ought to provide recourse could also mean that we are digging ourselves a deeper hole for future years, doesn't it?

Mr. BOWSHER. Well, if you do that, you then have a claim on future—and that's correct.

Senator LEVIN. One last question, Mr. Chairman, on the profit policy issue I understand Senator Bingaman discussed this issue with you this morning, earlier this morning?

Mr. BOWSHER. Early this morning, Senator.

Senator LEVIN. GAO has audited the DFAIR study and found it to be seriously misleading on the question of defense contractor profits. My question is this: Rather than trying to shift that responsibility to other agencies to make profit studies in the future, which is what I think you are suggesting, shouldn't we require legislatively or otherwise that the agencies do this right, that the DOD and GSA particularly do profit studies according to correct standards, and then have GAO audit these studies?

Mr. **Bowsher**. It could be done that way, but one of the main reasons we suggested in our exposure draft getting it to a neutral party was the industry's concern about what they call proprietary data going into the study. And what the Defense Department has done in the past is they've always hired an outside firm to collect the data and to provide that assurance. And what we thought is that you could have it done by a government agency with procurement expertise apart from the Defense Department.

Senator **Levin**. And the outside firms would work with that work?

Mr. **Bowsher**. That's right.

Senator **Levin**. Do you have the assurance that that's likely to follow?

Mr. **Bowsher**. Well, we think it can work because it's worked well in the past, and I think that even an existing agency like OFPP, or some other agency statistical like the National Bureau of Standards, could bring the information in and do the analysis; they could even hire an outside firm like LMI, the Logistics Management Institute, which did the original profit study—and so I think by doing that you then give the industry the assurances that they want, that their individual data will not be exposed to the Defense Department people that they are contracting with.

Senator **Levin**. But you have checked that with the industry to see that they would be satisfied with that assurance?

Mr. **Bowsher**. I think the industry is satisfied with that assurance. They have other concerns, primarily that the whole profit reporting thing will be used eventually to control profits, and I think that's their major concern.

Senator **Levin**. Thank you, Mr. Chairman.

Chairman **Glenn**. Thank you, Senator Levin. A couple of other questions here—I know it's getting late. On this missing inventory thing that we talked about in the military, do you think any of those weapons are getting into the hands of domestic terrorists?

Mr. **Bowsher**. That is the indication based on some of the investigations that the Army and the Treasury and other people have done, that's correct.

Mr. **Conahan**. We will be reporting to you, Mr. Chairman, on that matter at the conclusion of certain work that we have under way right now.

Chairman **Glenn**. Do you have any timetable on that as to when that will be done?

Mr. **Conahan**. I think it will take us several months before we are able to give you an indication of exactly where we are going.

Chairman **Glenn**. Well, if there is anything along the way in your investigation before the final report is ready that we should know about, that we should take action on, we would like to know about it very early.

Mr. **Bowsher**. We'll keep you informed.

Chairman **Glenn**. Thank you. Do you have a dollar estimate on this overpayment of defense contractors? Can you attach a dollar figure to that, what the excess is?

Mr. **Conahan**. Well, I think I would like to answer that as follows. In the DFAIR study that we talked about earlier, the Department of Defense concluded that the defense contractors' profitability was about comparable to durable goods manufacturers. In their methodology, they included certain payments made by the Department of Defense to the contractors in making the calculation. We believe that generally accepted accounting principles would dictate that those payments be taken away from the calculation.

If you do that, our conclusion is that defense contractors during the period of study have essentially been twice as profitable as the durable goods manufacturers as reported by Defense. Now, that's one thing.

The second thing is in its own study DFAIR said that contracting officers were going into negotiation with objectives somewhere between one-half and one percent higher than should be under DOD profit policy, and recommended reductions. And that would amount to about a billion dollars a year. We will agree that it's at least that, but, based on our calculations, we think it's more—we haven't quantified what more is.

Chairman GLENN. Defense contracting is a little unusual; it's not like turning out so many trucks a year that you plan in advance and you know what the market's going to be and so on. It's an on-again-off-again, boom or bust situation. There are huge costs associated with setup, plant upkeep and overhead.

Did you allow for that, and still feel that the profits are really excessive, above all the fluctuations back and forth? What I was getting at was you are talking about regular durable goods manufacturing, such as manufacturing refrigerators or whatever; that's a little bit different than an up-and-down off-and-on-again defense contracting situation.

Did you allow for that?

Mr. CONAHAN. Well, the Department of Defense, in concert with defense industry and some of the outside help that they had, like Logistics Management Institute, were the ones who decided that the comparison with the durable goods manufacturers was the most appropriate. And we didn't feel that we had any basis for questioning it.

Mr. BOWSHER. In fact, if I could add, Mr. Chairman, that's really been done now for the last couple of their profit studies. And our main objection this time was this adding the progress payments back; in other words, this is something they did all of a sudden with this profit study, and they hadn't done it with previous profit studies.

And that's my concern about getting some criteria that we can all agree on and then look at the figures periodically.

Chairman GLENN. You alluded earlier, in your discussion with Senator Roth I believe, to the need for perhaps a whole new office of financial management in the executive branch—or that was what I gathered, wasn't it?

Mr. BOWSHER. I'm not sure that that's necessary unless the Treasury Department isn't willing to do it. I am very strong against OMB being the central financial function, because they are so preoccupied with the budget—I think that's their major role. And I think that the Treasury——

Chairman GLENN. If we went to a 2-year budget, would that help?

Mr. BOWSHER. I think it will help with some parts of the budget, and I think it should be considered in some parts. I'm not sure about the total.

But I really think that we've either got to have a strong central function in the Treasury Department, or we've got to have maybe a separate group—that's really the two options.

Chairman GLENN. We'd like to work with you as you look at this thing. If you have more information, why I'd welcome any personal visits or information that you can supply to me or to the staff of the committee along this route, because this would be the committee that would have to pass on that and recommend it if it was to be considered.

Mr. BOWSHER. We'd be pleased to do that.

Chairman GLENN. One other thing I'd like to ask for. You made five specific recommendations in your statement—five specific elements of your solution to our financial management problems.

Would you care to elaborate on that? For instance, how important is centralized leadership to this?

Mr. BOWSHER. Well, that's the very issue we've just been talking about, whether you have the centralized leadership in Treasury or whether you need a new function in the executive branch. But what's been missing really since 1950, when the Budget and Accounting Act was passed, is just that very issue, and that is we've had too much sharing of responsibility, sharing of accountability, and the systems have deteriorated. And therefore I think that somebody has got to take responsibility of making sure the systems are in place, and also that the financial or the scorekeeping at the end of the fiscal year is done properly.

I think the auditing, as Fred Wolf mentioned earlier—I think you've got to audit these financial reports to keep the discipline up. I think one of the classic examples we've faced in the last year here when you don't do that is the farm credit system; in other words, we are in deep trouble with that program because for many years it was audited and then it bought itself out literally from the government, did not have annual audits, their information didn't keep up with it, and they were getting deeper and deeper into trouble, and, until we found some of the problems there about 2 years ago, why people just weren't aware of just how bad that situation is getting—and I think we face a very large bailout in that situation that might make Chrysler, Lockheed, and a few others look very small.

So I think these reports have got to be audited on an annual basis. And I think to do a good audit you've got to have basic systems; you've got to have those systems in place in the twenty major departments that make up 95 percent of the government. That's really the whole key to the future.

Chairman GLENN. Out of that block now, you are talking about the make-up of 95 percent of the budget. Out of that 95 percent of the budget in the 20 departments, how many different accounting systems should there be? In other words, I'm thinking of taking a bite out of this apple to get things standardized—starting to bite at it anyway.

Mr. **Bowsher**. Offhand I can't give you that number, but we can certainly provide it. We have that data, and we can certainly provide it. And I think that's the important area to begin.

[The information referred to follows:]

ACCOUNTING SYSTEMS REPORTED BY AGENCIES
FISCAL YEARS 1984-1986

Agency	1984	1985	1986
USDA	13	13	7
DOC	8	10	10
DOD[1]	150	132	114
EDUC	21	29	28
DOE	9	10	8
HHS	79	56	36
HUD	4	6	8
DOI	12	12	13
DOJ	1	7	7
DOL	1	18	17
STATE	5	6	2
DOT	18	18	13
TREAS	26	26	26
EPA	1	1	1
GSA	47	1	17
NASA	20	20	20
SBA	6	6	6
VA	6	6	6
Total Major Agencies Reviewed By GAO Under FIA (95% of budget)	427	377	339
AID	4	3	3
FEMA	1	1	1
NSF	1	1	1
NRC	13	13	13
OPM	19	19	19
Total Other Major Agencies Reporting To OMB	38	37	37
Total All Major Agencies	465	414	376

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[1] DOD total includes systems for Army, Navy, Air Force, and other Defense agencies.

Chairman GLENN. It would seem to me if we started in that area, we are at least approaching the biggest problem and getting them standardized, and then you could bring the others in.

Mr. BOWSHER. That's right. And what I think, too, is that we could get the smaller agencies using those systems. There's nothing worse now—I always use the illustration of the poor old Federal Election Commission; they came into being, they had to go get their own accounting system, they had a RIF over there one time, and one person got control of the whole accounting system and he stole $50,000. And we had to go over and decertify that little system. And that goes on every time we create an agency with the present approach.

Chairman GLENN. Do you, in your own operation, have adequate funding to do the job you are supposed to do?

Mr. BOWSHER. Well, I think we have adequate staff to do our job, but I really think, if we are going to audit these statements, it's a case of working with the IG's and the CPA profession can do a number of them. And so I think between those three groups we can get the job done.

Chairman GLENN. Do you do your operation all internally or do you contract out for any accounting help?

Mr. BOWSHER. We have contracted out for a limited amount of help, but most of it we do ourselves.

Chairman GLENN. Senator Levin?

Senator LEVIN. Just a couple of more questions on the defense contractor profit issue. What is the greatest source of the type of excess profit which you have identified as amounting to half a billion to a billion dollars? Is that because the negotiators for the government did not follow our guidelines or that they ended up in the top range of allowable profit within those guidelines? What's the greatest source of just that one cause of excess profits?

Mr. CONAHAN. One of the principal causes is the one that you stated, that our negotiators are going to the top range of the percentages allowed by the weighted guidelines, so that there is a very high level of that kind of behavior out there.

The 1980 adjustment to the weighted guidelines was to result in a level of profit then determined by the Department to be appropriate, and the half percent to one full percent is above that level.

Mr. BOWSHER. One of the other problems, too, Senator, is that we have only done these profit studies every ten years, and so when you do a profit study in the middle seventies and you work out these weighted guidelines that all these individual contracting officers are dealing with, and then you get high interest—you know, we went from single digit to double-digit interest rates, we didn't change the weighted guidelines because there was no new information. And that's one of the things that we are saying here is you've got to have this kind of information flowing so you can take a snapshot every three years and see if the guidelines ought to be adjusted by all these different contract officers who are working with the industry. If you wait ten years, conditions change too much on you.

Senator LEVIN. Does this problem exist outside of the DOD? Does GSA have the same problem or other——

Mr. **Bowsher**. Well, it's primarily a DOD problem, and NASA, and, to a lesser extent, in GSA and the other civilian agencies.

Senator **Levin**. Thank you, Mr. Chairman.

Chairman **Glenn**. Let me ask, do any of the staff members here representing other Senators have any questions they want to get on the record? Staff?

Thank you. This has been excellent this morning. And our hearing tomorrow will once again be on waste, fraud, and abuse. The Inspector General's needs and operations will be our focal point. We'll have the Honorable Richard Kusserow, the Inspector General of HHS, and Vice-Chairman of the President's Council on Integrity and Efficiency; the Honorable James R. Richards, Inspector General of the Department of the Interior; John J. Adair, Associate Director of the Fraud Prevention and Audit Oversight Group of GAO; and Charles Clauson, Chief Postal Inspector.

Gentlemen, I think this has been excellent this morning. You've been very forthcoming, and we appreciate it and we certainly look forward to working with you. Thank you.

The hearing will recess.

[The committee recessed at 12:10 p.m. to reconvene at the call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF CHARLES A. BOWSHER

Mr. Chairman and Members of the Committee, I am pleased to discuss today the need to strengthen and improve the government's overall financial management systems and agency operations and accountability.

Demands to fund current programs as well as to provide for new investment in national defense and capital improvements continue unabated. However, with annual deficits exceeding $200 billion and an accumulated deficit over $2 trillion, the shortfall in meeting government outlays is critical, and our management processes have not been able to cope with this situation.

As the Congress and the President grapple with the budget deficit, it is imperative that ongoing operations be as efficient and effective as possible. We must be sure that every dollar is spent wisely and that there is full accountability.

Based on audits and evaluations of the major programs and operations of the government that GAO has completed during the 6 years I have been Comptroller General, I believe there are four areas that demand our immediate attention if we are to bring about necessary improvements.

First and foremost, **I believe that the deficit of the federal government is the major problem which faces us today, and it must be dealt with.**

Second, the financial management systems used and concepts followed by the federal government are inadequate to deal with a trillion dollar federal government operation.

Third, I have major concerns about the management of the operations of some of our major government activities and programs, such as the IRS, FAA, the Farm Credit System, and the Social Security Administration's computer modernization program, which affect the lives of millions of our citizens.

Lastly, I believe that the accountability to both the public and the Congress in such areas as Defense procurement, international assistance, and intelligence is inadequate.

Yesterday I gave a speech in San Francisco on the deficit issue, which I am submitting for the record. This morning I would like to focus on the other three issues, financial management, agency management, and accountability, since they are important both to insuring that we effectively and efficiently carry out our public mandate and to dealing ultimately with our federal deficit. I would like to outline for you the problems in these areas and then focus on a series of suggestions which we believe would begin to deal with these problems.

FINANCIAL MANAGEMENT

Focusing first on financial management, we have serious, long-standing internal control weaknesses which have resulted in a litany of horror stories. For example, serious flaws in controls over Defense's $160 billion inventory have resulted in fraud, waste, and abuse which has been documented in many Defense and GAO reports. Also, many agencies continue to have serious problems in systems used to collect and account for the government's reported $300 billion in receivables, with billions of dollars going uncollected or being written off.

Our accounting systems are old and in bad shape. The basic structure was laid out in World War II, and many of the systems are built around 1950's vintage concepts and computers. The systems have become inefficient as new requirements have been layered on old without changing the basic structure. They are costly to operate and maintain, and they still do not produce the complete, consistent, reliable, and timely data needed for deciding policy or managing day-to-day operations. For example, the Veterans Administration cannot tell you how much it actually costs to care for a patient or to run a hospital, which is information that is necessary to control costs and effectively manage its programs.

Current financial reporting and budget practices do not disclose the actual costs of operations or the current and probable future costs of investment decisions, such as the procurement of major weapons systems. They do not permit comparison of actual costs and accomplishments to budget plans and do not disclose the financial position of the government.

Finally, the accuracy and reliability of financial information about the federal government is uncertain because most of the information is unaudited and financial statements are not prepared. The Farm Credit System, which I will touch on shortly, demonstrates what can happen when we lack adequate financial statements and financial audit.

Improved financial management systems will not make difficult decisions easy, but they will give policymakers and the public the information they need to better understand the issues, the choices available, and the consequences of those choices for the American people. Improved systems will help us in controlling resources and establishing accountability, and will provide agency managers the information they need to manage the day-to-day operations of our government.

AGENCY OPERATIONS

The government's financial problems are compounded by serious problems in the management of agency operations. In the past year, we have seen critical program operations in trouble. The problems the IRS experienced in processing returns in 1985 seriously diminished public confidence in the agency. The near-record 561 deaths from U.S. airline accidents in 1985 heightened public and congressional concern over how well FAA is overseeing aviation safety. The Farm Credit System, our country's largest agricultural lender, is in serious financial distress, in part because of poor management practices and decisions. The Social Security Administration's efforts to improve its service to the public by modernizing its computer system have experienced a number of problems, and service continues to be less than it should be.

A panel of experts at the National Academy of Public Administration concluded in a 1983 report, Revitalizing Federal Management, that the government had experienced a decade of declining managerial effectiveness despite efforts to solve specific management problems. I see no evidence that this has changed.

The need for strengthened management systems has been borne out by the general management reviews GAO has completed in six departments and agencies. These reviews have shown that current approaches to management in the federal government are not getting the job done well. The problems resulting from frequent turnover of top level agency leadership; little or no focus on long-term planning; and difficulty in maintaining an effective federal workforce are common themes that have emerged from these reviews. There is also a need for greater attention to developing adequate support systems, such as strengthened financial management and reporting systems, which can help to increase accountability within the federal government.

ACCOUNTABILITY

I have been concerned about accountability for some time, especially accountability for contractor profitability in government contracts. There is ample reason for concern when government procurement is almost $200 billion a year, much of which is awarded through negotiated, non-competitive contracts.

The cost of our national defense has increased by almost 100 percent since 1980, and procurement is a major share of this growth. Over the past two decades, Defense has performed two major studies to assess its contractor profit policies; the latest, completed in 1985, was the Defense Financial and Investment Review (DFAIR). GAO performed a review of the DFAIR study for this Committee and found the profitability information in DFAIR to be seriously misleading. We concluded that profits of defense business were substantially greater than reported and substantially higher than in the commercial sector.

Another important facet of government accountability is the audit of and proper control over all government accounts, including sensitive accounts. Establishing proper accountability over some programs is difficult because of their very nature. For example, our reviews of U.S. foreign assistance programs in the Philippines and other countries identified control and accountability problems which resulted in diversion of funds to unauthorized use.

Concerns about accountability frequently surface over government activities and programs which are not subject to normal public scrutiny, such as very secret military weapons projects--sometimes called "black" programs--and sensitive intelligence activities. Programs of this nature require special access and are known to a relatively small number of people. Over the past several years, we have increased our audits and reviews of these activities. We have been successful in obtaining access to review highly classified weapons programs and tactical and strategic command, control, communications, and intelligence programs.

The one major exception has been Central Intelligence Agency activities. Here we have been unsuccessful in gaining similar access. The CIA takes the position that GAO's involvement in reviewing CIA activities is not necessary because the select committees on intelligence are the Congress' oversight mechanisms.

SOLVING THE GOVERNMENT'S MANAGEMENT PROBLEMS

There are solutions to the problems I have outlined for you today. These solutions require strong leadership from both the Executive branch and the Congress.

1. First, we have seen through the experience of state and local governments and other organizations we have studied that a successful program of improving financial management is possible. There are five elements to the program:

    - Centralized leadership and the development of a financial management reform plan.
    - Audited financial statements to achieve discipline and accountability.
    - Upgraded accounting systems that not only provide fund control but needed financial and management information as well.
    - Budgets that include costs and long-term investments along with receipts and outlays.
    - Focus on improving internal controls.

In 1985, GAO proposed a conceptual design for a modern financial management system in our report, Managing the Cost of Government, which I am submitting for the record along with a joint study on federal reporting that we conducted with the Auditor General of Canada. In 1986, I also commented extensively on this issue in a letter to Senator Proxmire which I have also included for the record.

2. Second, we need to upgrade our major agency operations. GAO plans to continue its agency management reviews to focus on high level management problems. The agencies' leadership has reacted positively to our management reviews. I would hope that the Congress will use these reviews and other means to begin to address long-standing major problems. The Congress, together with GAO, needs to focus on the major operations of the government.

3. Third, we need a program for defense contractor profitability reporting. We have a recent exposure draft outlining a program for contractor reporting and verification of that data by external auditors as a means to begin to deal with this problem and help assure fair and reasonable profit in the negotiation of government contracts. I am providing you a copy of that draft which contains suggested legislative language for a bill to implement an acceptable profitability reporting program.

4. Finally, we need to improve accountability and oversight of sensitive government activities. If the Congress were to determine that GAO should be involved, legislation to clarify this matter would facilitate our auditing of the CIA. We are prepared to carry out that responsibility. And I believe GAO could be very helpful in assisting the Congress in its oversight of these important and sensitive activities.

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In conclusion, Mr. Chairman, while the problems I have outlined are significant and long-standing, there are ways we can begin to solve them. I believe there is a positive role for the Congress in addressing each one of these issues, and we want to work with you and your Committee in improving government management. I have attached a more detailed discussion of these issues.

This concludes my remarks. I would be happy to answer any questions.

This attachment provides GAO's detailed views on the need to strengthen and improve the government's management systems, structure and accountability together with GAO's suggestions for beginning to deal with problems in these systems. These systems and structure are the heart of the our government's ability to provide quality services economically and efficiently, with full accountability for the expenditure of public funds.

Demands to fund current programs as well as to provide new investment in national defense and capital improvements continue unabated. However, with annual deficits in the range of $200 billion and an accumulated deficit on the order of $2 trillion, the shortfall in meeting government outlays is critical. Every day of the year, the government spends about $500 million more than it takes in.

As the Congress and the President grapple with the budget deficit, it is imperative that ongoing operations be as efficient and effective as possible. The government must be sure that every dollar is spent wisely and that there is accountability.

Efficient and effective operations can only be accomplished if the government has adequate management systems. Unfortunately, despite some progress, the government does not have these systems, nor does GAO see the programs underway to develop them.

- --The financial management systems used and concepts followed by the federal government are inadequate to deal with a trillion dollar federal government operation.
- --The management of the operations of a number of major government activities and programs, such as the IRS, FAA, the Farm Credit System, and the Social Security Administration's computer modernization program, which affect the lives of millions of our citizens, need to be strengthened.
- --Accountability to both the public and the Congress in such areas as Defense procurement, international assistance, and intelligence is inadequate.

URGENT NEED FOR FINANCIAL MANAGEMENT REFORM

Reform of the government's management systems and operations is needed. The first priority is comprehensive overhaul of the government's financial management systems. Controls over government programs and operations are often either nonexistent or inadequate. Furthermore, the government's antiquated accounting systems often do not provide either timely and reliable program and financial information or accountability over the government's resources and their use.

Improved systems will not make difficult decisions easy, but they will give policymakers and the public the information they need to understand the issues they face, the choices available, and the consequences of those choices for the American people. Improved systems will help ensure that government resources are properly controlled and that we have financial accountability. Without these fundamentals, government cannot hope to regain the confidence of the American people. Likewise, improved systems will provide agency managers the information they need to manage the day-to-day operations of our government.

The federal approach to financial management has not fundamentally changed since World War II, despite the major advances in computer and telecommunications technology. Many of the systems are built around 1950's vintage concepts and computers. The systems have become inefficient as new requirements have been layered on old without changing the basic structure. They are costly to operate and maintain, and they still do not produce the complete, consistent, reliable and timely data needed for deciding policy or managing day-to-day operations.

Strengthening Management Controls

Serious and often long-standing internal control weaknesses have resulted in wasteful spending, poor management, and losses involving billions of dollars. In some cases, outright fraud has occurred, and in others, the government's ability to carry out crucial public services has been hampered.

As shown in agency's reports under the Federal Managers' Financial Integrity Act--an act passed under the leadership of the Senate Governmental Affairs Committee--these problem areas persist in a wide range of areas.

Comparison of the Number of Agencies Reporting Material Weaknesses by Category

Category	Number of Agencies (out of 18) 1983	1984	1985	1986
Financial management and accounting systems	17	17	17	17
Procurement	14	14	13	13
Property management	14	15	16	16
Cash management	12	12	12	13
Grant, loan, and debt collection management	13	13	14	11
Automated data processing	10	14	17	17
Personnel and organizational management	10	12	11	16
Eligibility and entitlement determinations	9	10	9	8

Agency Financial Integrity Act reports, inspectors general audits, and GAO reviews have shown the serious impacts of continuing internal control weaknesses. For example:

--Flaws in the armed service's management of Defense's $162 billion inventory have been documented in well over 300 prior Defense and GAO reports. The lack of basic internal controls makes it impossible for Defense to effectively manage its inventories and has resulted in untold fraud, waste, and abuse. We reported last year that the Army could not determine how much ammunition and explosives are lost each year. Large quantities are stolen, including such lethal military items as C-4 explosives, grenades, and claymore anti-personnel mines which have reportedly fallen into the hands of extremist organizations. Equally important, the Army's ability to effectively manage its inventory in support of its mission is hampered.

--Agencies continued to disclose serious weaknesses in automated systems that control billions of dollars in federal funds. For instance, the Department of Health and Human Services (HHS) continues to have control problems in the systems designed to ensure accurate, complete, and timely recording of earnings on over 300 million earnings records. The Veterans Administration does not have adequate contingency plans to deal with any long-term disruption at its data processing centers which process about $24 billion annually in veterans benefits, medical care, and pensions. In our 1985 survey of ADP security at 17 agencies, all 25 of the automated systems we looked at were vulnerable to error, fraud, waste, abuse, and destruction because essential controls and security safeguards were lacking.

--Agencies, collectively reporting over $21 billion in delinquent debts at the beginning of fiscal year 1986, 92 percent of the government's total, reported having material weaknesses in debt collection. The Debt Collection Act of 1982, sponsored by the Committee, provided agencies with the tools they needed, but agencies have been slow in getting the act implemented. Billions continue to go uncollected, and additional billions are written off annually. In August 1986, the Director of OMB, in imploring agencies to address this problem and the effects of "decades of financial mismanagement and bureaucratic inertia," stated that the "failure to employ every conceivable tool at our disposal to bring this situation under control would be an abdication of our responsibility to the taxpayer . . ."

--Despite progress since passage of the Prompt Payment Act of 1982, also enacted under the leadership of the Senate Governmental Affairs Committee, agencies are still not paying contractors on time. In August 1986, we reported that about one-fourth of all contractor invoices were paid late. At the same time, payment of a significant part of its invoices earlier than due continues to cost the government millions of dollars in lost interest.

--Agriculture continues to have problems recovering overpaid benefits in its $11 billion Food Stamp Program. Losses due to overpayment of benefits are nearly $1 billion annually. States have experienced difficulties in their collection practices, with only about 3 cents on every overpayment dollar recovered during fiscal years 1981 through 1984.

Strengthening Accounting Systems

Adding to the government's dilemma is the overall poor condition of agency accounting and financial management systems. Although conformity with the Comptroller General's accounting requirements was mandated by the Congress 36 years ago, many accounting systems still do not conform or provide the financial information needed to manage the government efficiently and effectively. At the end of 1986, agencies' Financial Integrity Act reports cited hundreds of material weaknesses in their systems. Billions of dollars are not being adequately accounted for, managed, or financially controlled.

The Department of Defense, which reported that 52 of its 114 accounting systems do not conform, does not have adequate accounting control over assets, liabilities, and capital, totaling billions of dollars. For example, despite the issuance of over 50 GAO, inspectors general, and internal audit reports over the past 15 years, Defense has been unable to maintain full accounting and financial management control over its multibillion dollar foreign military sales program. In addition to other problems, Defense cited its inability to consistently reconcile differences between its cash disbursement and delivery reporting records. At one point in 1986, the unreconciled differences were $742 million.

The Veterans Administration's (VA) financial management systems do not capture and report actual per hospital or per patient cost information. Consequently, VA officials are forced to use unreliable medical program cost estimates when developing plans, formulating budget requests, and executing approved budgets. They do not have the information needed to plan and manage VA medical programs most efficiently and effectively.

Improving the Budget

We need to improve the structure and content of the budget. The last major reform of the budget, entailing the creation of the modern unified budget, was in the late 1960's, the result of the work of the President's Commission on Budget Concepts. That earlier reform must be built upon and a more useful budget developed.

Particular attention needs to be given to developing a budget that better distinguishes between capital and operating amounts and between trust and non-trust fund amounts, and a budget that does not treat loan programs the same as grants by charging off the full loan amount in the first year. For instance, by combining capital and operating amounts, we blur an important distinction which can result in a bias against major long-term investments, such as replacing the government's antiquated computers and systems.

Dealing with the budget deficit also requires that we deal with the issues at hand rather than finding artificial numbers' solutions. We are concerned that many of the proposed "savings" for fiscal year 1987 are questionable, since they merely shift outlays or collections from one fiscal year to another, with no impact on the structural deficit we face. Members in both houses of the Congress and on both sides of the aisle have spoken out about the "blue smoke and mirrors" being used to meet the deficit targets; this is an area which concerns us greatly and which further contributes to the lack of public confidence in our government.

Improving Accountability

Another essential component of strengthened financial management is the preparation and audit of agency and government financial statements. It is time for federal agencies to prepare annual financial statements so that the Congress and the public, not to mention the agencies themselves, have complete, accurate, and timely information on their financial position and results of operation. Since 1934, publicly-held corporations have been required by law to prepare annual financial statements which can withstand the scrutiny of an independent audit. The Single Audit Act of 1984, passed under the leadership of the Senate Governmental Affairs Committee, likewise requires state and local governments receiving federal assistance to have comprehensive audits of their financial statements. The public deserves no less from the federal government.

The Government Accounting Standards Board summed up well the importance of accountability through financial reporting:

> ". . . financial reporting plays a major role in achieving public accountability in a democratic society. Public accountability is based on the belief that the taxpayer has a 'right to know,' a right to receive openly declared facts that may lead to public debate by the citizens and their elected representatives."

The problems of the Farm Credit System, which have been extensively reported and which we will touch on later, demonstrate graphically what can happen when financial statements do not follow acceptable practices and financial audits are not performed to assure the reliability of data and reports.

In another example, the federal government's plans to sell loan portfolios to the private sector could be hampered by the lack of reliable financial information on the value and condition of the underlying loans. Financial auditing could have helped pinpoint the sad condition of the government's loan account balances and records long ago. The Education Department, for instance, found that it could cost the Department about $75 million to prepare its supporting loan files for sale.

Yet another example involves the Maritime Administration (Marad), which was authorized in 1972 to encourage the construction of vessels in the United States by guaranteeing loans to U.S. citizen shipowners. This program faces serious financial problems. Yearly defaults, which were running at $100 million or less through 1984, began to increase significantly in 1985 and climbed to about $1.4 billion last year. The fact that the program's expenses exceeded its revenues, however, was not clearly shown in Marad's latest financial statements, and Marad budget estimates have been consistently understated. Marad has advised us that it will take corrective action to make these disclosures in future financial statements. Marad's financial reporting needs to be improved so that the Congress is not led to make policy decisions it would not make if the program's true financial condition was clearly presented.

Developing a Blueprint for the Future

So far we have focused on the problems. There are solutions. Lasting reform is achievable, and we must begin now. GAO has looked long and hard at the issue of financial management and has tried to determine what can be done to improve it. Although we have concluded that there are indeed solutions, we have at the same time concluded that there are no painless, easy or magical ones. However, the problem can be attacked under a longer-term approach.

For the federal government to be successful in reforming financial management, improvements must be guided by a cohesive framework and an overall plan with clear objectives. We must agree on where we want to go. We must assure continuity across successive administrations and work toward a common set of long-term financial management goals. We will need strong leadership in the Executive branch and support from the Congress.

In 1985, GAO proposed a conceptual design for a modern financial management system in our report, Managing the Cost of Government. Last year, we issued a joint study on federal reporting that we conducted with the Auditor General of Canada, and we commented extensively on financial management reform in a letter to Senator Proxmire.

We must start now to lay the groundwork for a new federal financial management structure that encompasses:

--strengthened federal accounting, auditing, and reporting;

--improved planning and programming;

--a streamlined budget process;

--comprehensive use of cost-based reporting;

--systematic measurement of performance; and

--improved and strengthened internal controls.

Such a structure would not only improve program planning but also help control costs by providing both the Congress and agency management with reliable, timely, consistent financial data to judge how well program decisions are implemented and to identify emerging problems so that corrective actions can be taken as necessary.

An improved financial management structure should also expand performance measurement in the federal government. Currently, attention is focused on the obligation and cash information needed to control appropriations and calculate the deficit. This approach provides information on valid cash management and fiscal needs, but it omits important information about the long-term costs of government.

There are solutions to the problems we have outlined. These solutions require strong leadership from both the Executive branch and Congress. GAO has seen through the experience of state and local governments and other organizations it has studied that a successful program of improving financial management is possible. There are five elements to the program:

1. Centralized leadership and the development of a financial management reform plan.
2. Audited financial statements to achieve discipline and accountability.
3. Upgraded accounting systems that not only provide fund control but financial and management information as well.
4. Budgets that include costs and long-term investments along with receipts and outlays.
5. Focus on improving internal controls.

BUILDING AN EFFECTIVE MANAGEMENT STRUCTURE

An area vital to our national well being is strengthening our government's capacity to manage its operations more effectively. We are concerned about the overall deterioration of our government management structure.

Management improvement efforts of the past decade or more have been relatively ineffective. GAO studied centrally directed, government-wide management improvement programs conducted in the 1970's, and found that few initiatives had lasting impact. Similarly, a panel of experts at the National Academy of Public Administration concluded in a 1983 report, Revitalizing Federal Management, that the government had experienced a decade of declining managerial effectiveness despite efforts to solve specific management problems. They reported that improvement efforts have been sporadic, poorly planned, and inadequately backed and staffed. We see no evidence that this has changed.

Need To Strengthen Program Operations

Our overall agency management systems need to be upgraded. In recent years, we have seen serious management problems in a number of our most critical government programs which highlight the practical consequences of management issues to government service to the public. The following focuses on five such programs.

The Internal Revenue Service. Probably no other federal agency has as great an impact on public perceptions of the efficiency and fairness of government as the Internal Revenue

Service (IRS). The IRS has attributed the recent increasing concern about citizen noncompliance with the tax laws to public frustration with a system that is perceived as unfair. The problems experienced with processing returns in 1985 further diminished the nation's trust in the agency's ability to administer the tax laws.

Although recovering from those processing problems, the IRS is now faced with the challenge of restoring public confidence, while implementing the most far-reaching revision of the Internal Revenue Code in 30 years. Negative public reaction to the new W-4 form is but one indication of how IRS will be tested in implementing the new law.

--Under the President's fiscal year 1988 budget proposal, IRS would receive 9,500 new employees to help it achieve the goal of increasing tax collections by $2.3 billion. Achieving this goal will be complicated by the absence of IRS agency-wide systems to determine where additional resources could best be allocated or whether existing allocations provide for the best use of IRS resources. For example, although IRS' inventory of owed but unpaid taxes rose by 31 percent between December 1984 and December 1985 (to a total of $45 billion), IRS has not fully defined that inventory or identified the reasons behind it. IRS thus does not have all the information it needs to determine how its resources can best be used to deal with these unpaid taxes.

--Heavily dependent upon computers, the IRS could find itself unable to meet its computer capacity needs over the next several years. IRS has not completed the necessary workload analyses nor has it monitored the performance of its current systems to have adequate information to determine the useful life of its computers. Accordingly, IRS could find itself short of computer capacity earlier than anticipated, without enough warning to take corrective action.

The Federal Aviation Administration. The near-record 561 deaths from U.S. airline accidents in 1985 heightened public and congressional concern over how well the Federal Aviation Administration (FAA) is overseeing aviation safety. Since airline deregulation in 1978, airline competition, increased air traffic, and aging air traffic control equipment have challenged FAA's ability to maintain air safety and ensure airline compliance with safety regulations. Specifically,

--FAA presently has fewer air traffic controllers than it did in 1981 even though air traffic has reached record levels. Controllers and their supervisors told us they are overworked and believe their ability to maintain an adequate margin of safety could eventually be impaired.

--FAA's National Airspace System Plan, designed to upgrade FAA air traffic control equipment and facilities, has been delayed because FAA underestimated its technical complexity. The delays mean that projected productivity gains will also be delayed, adding to pressures on the controller workforce and the equipment they must continue to use.

The Farm Credit System. The Farm Credit System, our country's largest agricultural lender, is in serious danger of not being able to fulfill its congressional mandate of providing reasonable credit to the nation's farmers. Due to adverse economic forces and poor management practices, this private, borrower-owned network is experiencing severe financial distress. It incurred over $4 billion in operating losses during 1985 and the first three quarters of 1986, as its loan portfolio and surplus deteriorated significantly.

The System's viability is in serious doubt, raising the strong possibility that the Congress may have to provide assistance to rescue some of the System's 37 banks. While this condition resulted partly from factors beyond the System's control, such as decreasing agricultural income and falling land values, it also resulted from poor management practices and decisions. These include:

--banks' lax credit management standards and mismanagement of interest rate risks, causing excessive interests costs;

--failure to follow acceptable practices in preparing financial statements and conducting financial audits to inform decisionmakers of the true dimensions of emerging problems;

--inadequate controls over operating costs; and

--incompatible automated data systems.

However, the most fundamental obstacle to addressing the System's problems is its management structure. The System is a complex decentralized organization consisting of hundreds of legal entities devoid of centralized decisionmaking, accountability, and authority. As the System is now organized, these entities are collectively liable for Systemwide debts but do not have the centralized decisionmaking needed to solve Systemwide problems.

The Social Security Administration. The Social Security Administration (SSA) touches the lives of almost all Americans and its program and administrative expenses presently account for about one quarter of the entire federal budget. A great deal of attention has always been focused on policy and benefit levels for various social security programs. However, SSA is experiencing problems in providing high quality service to the public in several areas due to inattention to various management programs.

For example; each year SSA puts out more than 40 million fully or partially computer generated notices to individuals concerning their benefit levels or eligibility. Most are fully computer generated. Unfortunately, these notices are often confusing, incorrect, or contain contradictory information. As a result, individuals must contact SSA by phone or visit a field office to get problems resolved. These efforts are often frustrating because SSA's field office employees frequently do not have access to the information needed to clarify the notice or resolve the problem.

SSA's computer systems are critical to its ability to provide quality public service. SSA's current efforts to modernize its systems began in 1982, and the agency estimates that through fiscal year 1988 it will have spent over $640 million on this effort. However, SSA is experiencing significant problems in its computer modernization program because a major thrust of the program--improving deficient computer software--has been delayed. Leadership problems are a primary factor underlying these delays. SSA has had frequent turnover in commissioners and has lacked technical and managerial control over the modernization effort. Consequently, needed improvements in public service, such as improving notices, which are closely tied to SSA's computer modernization effort, must wait until systems improvements are made.

The Department of Energy and The Nuclear Regulatory Commission. The 1986 Chernobyl accident has rekindled interest and concern over safety and environmental issues surrounding our nation's nuclear power facilities. The Congress, in assessing the government's role in operating nuclear facilities safely and regulating nuclear power plants, found much cause for concern.

The Department of Energy (DOE) produces nuclear power largely free of outside monitoring and oversight. However,

--DOE internal management procedures do not adequately determine whether nuclear facilities are operating at an acceptable level of risk. Key safety analysis reports used to show risk levels differ from plant to plant and are developed by DOE contractors and reviewed by DOE personnel, rather than by an outside independent source.

--Some states believe DOE's nuclear waste disposal practices create potential health threats. DOE is not subject to the same regulatory control over its nuclear wastes as is private industry. Continuation of existing waste disposal practices, without independent review, may lead to ground water and soil contamination.

In another matter involving nuclear power, the Nuclear Regulatory Commission (NRC) which is charged with oversight of commercial nuclear plants, lacks an Inspector General, who could provide the independence and expertise necessary to monitor and evaluate NRC operations and procedures.

Solving Our Management Problems

How do we correct long-standing management problems and prevent others from occurring. The answer lies in improving the management in our individual departments and agencies: building a better capacity to anticipate emerging issues; providing clear direction; developing a skilled workforce; and generating more reliable information on performance.

Recently, GAO began assessing major agencies' general management and recommending ways of strengthening their management capacity. To date, we have completed six general management reviews (the Departments of Housing and Urban Development (HUD), Labor, Justice, and Transportation and the Defense Logistics Agency (DLA) and SSA and are in the process of reviewing the Environmental Protection Agency, IRS, the Reserves and National Guard, and HHS.

While each agency has a unique operating environment and thus different problems, four common management and accountability themes are emerging from our completed work. The first of these, the need to gain better financial management control over operations was discussed earlier. The other three themes are:

--providing more effective leadership,

--better preparing for the future, and

--cultivating a more productive and motivated workforce.

Providing More Effective Leadership

The average term of political appointees over the past two decades has been slightly over 2 years. Such frequent turnover in leadership has presented recurring problems in the agencies we reviewed. For example, in the last 10 years, SSA has had 7 different Commissioners, two of whom operated in an acting capacity for extended periods. This situation has hampered SSA's ability to undertake critical and costly efforts to modernize its computer systems and to resolve long-standing problems impacting on its ability to serve our citizens efficiently and effectively.

The problem of frequent turnover of leadership is exacerbated by the growing number of appointed positions, as reported by the National Academy of Public Administration in its November 1985 study, "Leadership in Jeopardy - The Fraying of the Presidential Appointment System." That study seriously questioned the government's capacity to recruit and evaluate the large number of people now needed to fill all appointed positions.

Frequently, there also is insufficient accountability at the top levels of an agency for day-to-day management issues associated with running complex and large organizations. Former Deputy Attorneys General and other top Justice officials, for instance, recounted their preoccupation with legal issues and inability to adequately address important management concerns, such as developing the Department's computer capacity and coordinating policy initiatives. Our management reports on Justice, Labor, SSA, and HUD all contained suggestions for focusing greater accountability for management at top levels within the Departments, usually at the Undersecretary or Deputy Commissioner level. This is critical to sustaining actions to resolve long-standing problems and to providing a more cohesive institutional approach for directing and controlling operations.

Adequately Preparing for the Future

Our government's ability to provide needed public services, whether it is ensuring public air travel safety, dealing with problems caused by the deregulation of the financial services industry, or coping with skyrocketing farm and medical care costs, hinges largely on our capacity to meet the challenges of emerging economic, social, and technological trends.

Yet, we have typically found agencies operating in a reactive posture, consumed by crisis or implementing short-term agendas, with little or no focus on long-term planning. Often, objectives are not clearly defined and information systems are inadequate to produce the data needed to measure performance or make informed program decisions. Consequently, congressional program objectives are often not met and decisions to invest large sums in new computer systems are not made wisely. Some examples follow.

--SSA did not have a long-term plan setting forth its future service delivery goals and how it should be structured to meet these goals. Consequently, SSA's Office of Systems was using its own assumptions about SSA's future direction as a blueprint to guide the agency's massive computer modernization effort, which has come under widespread criticism. Also, the Administration was proposing to eliminate 17,000 SSA staff positions over several years, and SSA had no firm basis for deciding how best to absorb those cuts and still maintain efficient and effective service.

--Until 1985, nearly 7 years after deregulation, FAA did not have the nationwide workload data, staffing standards, and performance measures to justify to the Congress the number of inspectors needed to meet air safety and deregulation goals. As a result, FAA appeared unresponsive to public safety concerns, and the Congress imposed increases in inspection staffing in the absence of adequate data.

--The Labor Department did not have a comprehensive, long-term strategy for enforcing the Employee Retirement Income Security Act, and its strategy for selecting plans to review was weak. Plan selection methods were inconsistent among field offices, and little was done to evaluate the methods' effectiveness, hampering the effective use of limited program staff resources. As a result, there was little confidence in the government's ability to provide adequate coverage in this important area involving millions of workers. In 1986, Labor took actions to improve its methods for selecting plans to review.

Cultivating a More Effective Workforce

An agency's success in accomplishing its mission will be influenced significantly by how well it manages the recruitment, development, and performance of its people. However, we are finding several human resource management problems. For example, SSA is undergoing a number of changes, including staff reductions, computer modernization, and workload shifts. SSA will need to depend on its managers to address these challenges. But, SSA is facing potential retirements of over 300 managers over the next 5 years without effective agency-wide programs for identifying and developing potential Senior Executive Service or mid-level managers.

Labor's workforce has experienced considerable turmoil over the past 5 years. Several of its missions have been redefined, and the Department's workforce has been reduced through nine reductions in force. While some disruption is inevitable, a more systematic workforce planning process could have minimized the lengthy delays in filling critical vacancies, the resultant loss of efficiency, and the need to fill vacant positions with inexperienced personnel. Moreover, 51 percent of the Department's program managers we surveyed believed that the training and development programs for supervisory personnel were not very effective. In response to our recommendations, Labor developed and implemented a new human resource planning process and has developed a plan for improving training.

Achieving Positive Change

The political leadership in the agencies has reacted positively to our completed management reviews. For example, Secretary Brock designated the Undersecretary as the key management official for the Labor Department's improvement efforts, and established a system of long-term goals which includes a means of tracking progress. During a follow-up review, we found that Labor is off to an excellent start in addressing our recommendations.

Justice established a Department Resources Board to provide central management leadership and developed a comprehensive management and productivity improvement program. SSA has begun several actions, including creating a central planning function; developing SSA-wide objectives and a tracking system to hold managers accountable; and changing the leadership of its computer modernization efforts. The leadership in Transportation and DLA have also undertaken corrective actions.

However, history tells us that successful implementation of these improvement initiatives will be difficult. Active congressional oversight can help assure that corrective actions are sustained, and GAO is prepared to assist the Congress in providing that oversight. Our agency management reviews can serve to help establish agreement between the agencies and the Congress on a viable management improvement agenda.

We also plan a series of reviews at the central management agencies--the Office of Management and Budget (OMB), the General Services Administration, and the Office of Personnel Management--which will assist the Congress in assessing central agency performance. Additionally, GAO stands ready to assist the Congress in evaluating OMB's annual management reports. Such a broad, annual presentation of the Administration's management agenda provides a useful basis for continuing congressional oversight.

NEED TO IMPROVE ACCOUNTABILITY OVER DEFENSE CONTRACTS AND VISIBILITY OVER PROFITABILITY

Another key area of concern to GAO is the accountability for contracts and contractor profitability. The cost of our national defense has increased by almost 100 percent since 1980, with procurement a major share of this growth. GAO has done extensive work in the past few years looking at this area.

A major issue with accountability over government contracts is contractor profitability. With procurement currently amounting to almost $200 billion a year, much of which is awarded through negotiated, non-competitive contracts, there is ample reason for concern.

Profits, payment policies, and other contract elements that affect contractor profitability are negotiated in accordance with the procuring agency's profit policies. Currently, information on the profitability of the contracts negotiated by Defense is not routinely collected. Consequently, it cannot be determined whether the profits negotiated are achieving intended results.

Over the past two decades, Defense has performed two major studies to assess how these profit policies are working. The data used in these studies was provided by contractors who participated voluntarily. The responsibility for performing these ad hoc studies was different in each instance as were the methodologies used to analyze and evaluate the data.

The last study, completed in 1985, was the Defense Financial and Investment Review (DFAIR). GAO performed a review of the DFAIR study for this Committee. We found the profitability information in DFAIR to be seriously misleading and concluded that profits of defense business were substantially greater than reported and substantially higher than in the commercial sector. In a December 1986 report, we recommended, among other things, that the Congress establish a legislative requirement for a profitability reporting program and for periodic profit studies which should help assure fair and reasonable profit in the negotiation of government contracts.

Also, in this regard, in November 1986, GAO issued an exposure draft for a Proposal for a Program to Study the Profitability of Government Contractors. This draft contains suggested legislative language for a bill we believe is necessary to implement an acceptable profitability reporting program. The key elements of this program are:

--a consistent and appropriate analytical methodology to evaluate profitability;

--a means to verify contractor-furnished data; and

--mandatory contractor participation.

To provide increased accountability over government contracts, Congress in 1970 established the Cost Accounting Standards Board. The Board's purpose was to narrow options in cost accounting practices available to government contractors and increase accountability over government contracts by providing increased uniformity and consistency in cost accounting practices. The Board issued 19 cost accounting standards. GAO believes that those standards have helped significantly to establish the integrity and credibility of numbers used in government contract costing.

Since 1980, however, the Board has remained inactive for lack of appropriations. During the past 6 years, no governmental group has functioned to amend standards when desirable or to provide interpretations, waivers, exemptions, or perform other duties previously performed by the Board. We are concerned that the absence of a body to administer cost accounting standards has had and will continue to have a negative impact on the effectiveness of standards and the increased accountability they provide.

NEED TO AUDIT AND PROPERLY CONTROL SENSITIVE FUNDS

GAO is also concerned about accountability through the audit of and proper control over all government accounts, including sensitive accounts.

Establishing proper accountability over some programs is difficult because of their very nature. For example, in 1986, GAO reported that the State Department did not have sufficient controls to ensure that U.S. humanitarian aid to the Nicaraguan Contras was used as intended by law or to determine how over $225 million in foreign aid to the Philippines was used. As we reported last year, some Contra humanitarian funds were used to purchase ammunition and grenades, and massive amounts of funds were allegedly diverted, misused, or transferred out of the Philippines. Accountability has been hindered because many cash transfers have been commingled with other recipient government revenues, making a specific accounting for some of these resources impossible. We will continue to work on controls and accountability over foreign aid programs in selected countries during 1987.

Concerns about accountability frequently surface about government activities and programs which are not subject to normal public scrutiny. One such area is unvouchered accounts.

Concerned over the authority of the President and Vice President to spend money out of certain accounts without audit, the Congress in 1978 enacted Public Law 95-570 that authorized GAO access to the accounts and required a report to the Congress when such examinations were made and on any improper payments. Similarly, in 1980, the Congress amended the basic authority of GAO to provide broad access to audit unvouchered accounts in the federal government. This law requires the Director of OMB to provide GAO a list of all unvouchered accounts annually. It also requires the reporting of unresolved expenditures to selected congressional committees and provides the President authority to exempt from audit sensitive transactions involving intelligence or law enforcement.

We have issued seven reports on our examinations of unvouchered accounts of the Offices of the President and Vice President and the Departments of State and Defense which account for over 95 percent of unvouchered expenditures governmentwide. Although for the most part, the expenditures we reviewed were proper, our reports on State and Defense discussed some questionable expenditures, mostly in the area of entertainment.

Other areas which raise concern involve secret military weapons projects--sometimes called "black" programs--and sensitive intelligence activities. Programs of this nature require special access and are known to a relatively small number of people. Over the past several years, we have increased our audits and reviews of these activities. We have been successful in obtaining access to review highly classified weapons programs and tactical and strategic command, control, communications, and intelligence programs.

The one major exception has been Central Intelligence Agency activities. Here we have been unsuccessful in gaining similar access. The CIA takes the position that GAO's involvement in reviewing CIA activities is not necessary because the select committees on intelligence are Congress' oversight mechanisms. If the Congress were to determine that GAO should be involved, legislation to clarify this matter would facilitate our auditing of the CIA. GAO is prepared to carry out that responsibility, and believes it could be very helpful in assisting the Congress in its oversight of these important and sensitive activities.

THE IMPORTANCE OF THE INSPECTORS GENERAL

One way government accountability and management have been improved in recent years has been through the operations of independent federal inspector general organizations, an initiative strongly supported by the Senate Governmental Affairs Committee. Most major departments and agencies have had inspectors general since passage of the 1978 Inspector General Act.

GAO has long supported the inspector general concept, and would like to see it extended to several other agencies, most notably the Departments of Justice and Treasury. We have supported previous bills before the Congress that would establish inspectors general in Justice and Treasury, and we have previously recommended the establishment of inspectors general at the Nuclear Regulatory Commission and the Federal Emergency Management Agency.

THE BUDGET CRISIS: FINDING A WORKABLE SOLUTION

BY

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I would like to talk to you today about one of the most serious problems facing our federal government--the staggering budget deficit and the need to revamp our entire budget process to bring the federal deficit under control.

Back in the early 60s when I was a young accountant with Arthur Andersen & Co. in Chicago, I had the opportunity to hear a speech by Senator John McClellan of Arkansas at the Chicago Executive Club. I remember well Senator McClellan's prediction that the federal budget would soon reach the $100 billion dollar mark. Now, some 20 years later, we are faced with a budget of one trillion dollars and a federal deficit of more than $220 billion.

The consequences of our failure to control the budget have, in my view, become horrendous for our nation and indeed for the world. I believe that a bipartisan effort by the legislative and executive branches is essential to finding a workable solution.

In the next few minutes, I will hit you with a lot of numbers. But each of these numbers has a vital impact on individual lives and on the economic strength and welfare of our nation. It is a frightening story, but one that needs to be told and understood by every American citizen.

THE STATE OF THE BUDGET

To begin, let me recall that, in each of the last four fiscal years, from 1983 through 1986, the deficit has hovered around $200 billion. In 1986 it set a new record--$221 billion.

I believe the roots of the problem can be traced back to the early 1970s when two things helped lay the foundation for our present situation. First, we indexed a variety of programs just as we were entering a period of rapid inflation. This drove benefits up much more rapidly than anyone expected. When wages failed to keep pace because of slow economic growth, payroll taxes had to rise substantially, adding to later pressures for tax relief.

Second, at the end of the Vietnam War, we reduced our defense budget, creating the need to rebuild later. We began the rebuilding from 1976 through 1981 when defense outlays rose by 75 percent, from $90 billion to $158 billion. From 1981 through 1986, they rose by another 75%, to $275 billion. Thus, for the 10-year period as a whole, defense spending tripled.

We also cut taxes. Federal revenues dropped from 20 percent of GNP in 1981 to about 18.5% in 1986. That is about $65 billion in taxes we did not collect.

And we did not face up to what we had done. The rate of growth of domestic programs slowed dramatically, but the reduction was far less than was needed to pay for both the tax cut and the defense program.

In addition, we pursued a restrictive monetary policy. This was essential to bring inflation under control, but it triggered a recession which further eroded revenues. It also caused interest rates to rise dramatically, helping to more than quadruple federal interest costs from $30 billion in 1977 to around $135 billion in 1986.

These factors together turned a modest but vexing problem into a succession of $200 billion deficits and a doubling of the federal debt in five short years.

WHAT PRICE ARE WE PAYING?

Our nation's budget has been out of control for several years in a way that we usually think is reserved for mismanaged economies in unstable or backward countries. Yet most of our people are living relatively comfortably (provided you are not a heavily indebted farmer or a worker in heavy manufacturing or the oil and gas industry).

If you happen to be one of the lucky ones who has been doing reasonably well for the past eight or ten years, why should you care?

You should care, if for no other reason, because of self-interest. This failure of budgetary policy at the federal level has a price. Every taxpayer is paying some of that price today and will be paying a lot more in the years to come.

Take the cost of interest on the debt. The $135 billion we paid last year in net interest on the federal debt did not buy us a thing--except the privilege of paying it again this year. It didn't buy a single tank or airplane, it did not pave a mile of highway or replace a single obsolete bridge, and it didn't pay the salary of a single FBI agent or air traffic controller. Instead, it was a transfer of income from the average taxpayer to the holders of government bonds. And many of those people live in Japan and other overseas countries.

These interest costs come off the top of our federal budget, just as taxes and the mortgage payment come off the top of the family budget. Each year's deficit adds to next year's interest bill and to the portion of the budget which cannot be spent on the things our government needs to be doing.

Another part of the price is a nation which will grow more slowly than it would otherwise. We will go on paying that price for a long time to come.

In the 1960s our economy grew at an average annual rate (above inflation) of almost 4%. So far in the 1980s, it has been only 2.4%. That is an awfully important difference. Thousands of lost jobs are involved.

It translates into a lot of factories not built or modernized, unemployed people not put to work, and services not provided to the poor, the hungry, and the homeless. It also translates into lower tax revenues, further compounding the deficit problem.

The budget deficit is not the only reason for our present low growth rate. Clearly, the need to wring inflation out of our economy is a major factor. But the deficit is a significant impediment to future growth. I believe the deficits of the early 1980s caused the Federal Reserve to pursue a more restrictive monetary policy than would otherwise have been needed. In addition, many reputable economists believe--and I agree with them--that our problems in international trade and finance, which have direct effects on our domestic economy, cannot be solved until we bring the deficit under control.

We must understand what is actually happening today. When we borrow money from other countries, we spend it by importing more than we export. The nation as a whole is consuming more than it is producing. We are living well, for now, by borrowing the output of other people's factories, mines, oil wells, and financial institutions.

When we have to pay back what we have borrowed--even the interest charges--we must consume less as a nation than we produce. Just as we are benefitting from other people's labor today, others will be able to claim a portion of the fruits of our labor in the future. The longer we try to postpone it, the higher the price we must pay in the end.

WHAT MUST WE DO?

This brings me back to the crux of the matter--the budget deficit. What must we do and how can we do it?

The first thing we must do is face reality. The deficit is an urgent problem and we must deal with it. We must also be realistic. There are no easy, painless ways of cutting the deficit, nor can it be done overnight.

To understand why it is so difficult to cut spending, you need to think about what makes up our budget. In fiscal year 1986, we collected $769 billion in revenues. Interest on the debt took the first $135 billion, leaving about $635 billion to spend on programs. Almost $275 billion of that went to the military, and another $10 billion went for defense-related foreign assistance, leaving about $350 billion to cover everything else before we had to begin borrowing.

Let's look at the rest of the budget for a moment and see what would have been required to reach a balance. We spent $200 billion on Social Security; $70 billion on Medicare; and another $90 billion on other benefits for retirees, veterans, and the unemployed. Then let's stop, because we have now spent every dollar we raised in taxes. In fact, if we hadn't spent another dime, our budget would have had a $10 billion deficit.

But the fact is that there were a lot more dimes to be spent on programs and services which many citizens consider essential. First, I would like to add the $7 billion it took to run the IRS, because otherwise we would have had a hard time collecting any taxes at all. Then let's include the $5 billion it took to run our beleagured Federal Aviation Administration. And what about the Justice Department and the federal court system? That cost us another $5 billion or so, primarily for the Federal Bureau of Investigation, the Drug Enforcement Administration, the Immigration and Naturalization Service, and the prison system.

Do you think we should stop here, with a deficit of about $30 billion? You might, but a lot of other people wouldn't. The farm price support program took $25 billion and the highway program another $14 billion. Are you ready to abolish the National Aeronautics & Space Administration, another $7 billion? What about the $1 billion we spent on various food safety programs, such as the Food and Drug Administration, or the $5 billion we spent on medical research at the National Institutes of Health and the Centers for Disease Control? Do you think we should close the national parks and forests to save the $3 billion they cost to operate last year? If you think we should protect all these programs, you should also understand that we have now built a budget with a deficit approaching $85 billion, and I haven't even mentioned the $55 billion or more we spent on major welfare programs, or the $8 billion in assistance to college students.

The list of things which people want to keep in the budget could be a lot longer than this. I am not trying to defend these programs. Many could operate more efficiently, and some need basic reform. GAO has always been at the forefront of efforts to make these improvements. Last year alone, for example, our recommendations led Congress and the executive branch to save or redirect almost $20 billion. But we have to be realistic. Improved efficiency alone will not solve our $200 billion problem.

To solve this problem without new taxes, and without touching Social Security or the defense buildup, you would have to eliminate most of the other functions of our federal government. I don't think the American people would permit that, but in recent years the people and their political leaders seem to have forgotten that if you want programs, you must pay for them.

If we're going to solve this problem, we must all be willing to compromise. Right now, we just don't collect enough taxes to pay for all of our programs.

We must be prepared to take a hard look at the defense budget. The defense program must not be gutted, but neither can we continue the pace of the past seven years. The Defense Department cannot manage that rate of growth efficiently, and the public will not support it. Over the years, we have heard a lot about the futility of "throwing money" at social problems. I think we have become equally careless in how we spend money on defense. And the upward pressure on defense spending will continue. We now face the rising costs of operating and maintaining the new weapons that are pouring out of the plants.

We must be prepared to negotiate on the entitlement programs, especially Social Security and Medicare. Our growing population of retirees deserves protection--particularly those in the lowest income group. But retirees as a whole must share some of the burden of reducing the deficit. A modest constraint on cost-of-living adjustments for Social Security beneficiaries could make a significant contribution, particularly if coupled with meaningful controls over Medicare costs. Such constraints will be difficult, but they are essential, particularly if we enter another period like the 1970s, with wages not keeping pace with accelerating inflation.

We must lower our expectations about how much government can do about some problems. The abuse of drugs is a very serious problem in our society--one we would all like to see solved. But I'm not sure we know enough about how to solve it to spend another $1.5 billion per year wisely. Similarly, our farmers face very real problems. But I'm not sure our farm price supports help enough to be worth the $25 to $30 billion we will spend on them this year, up from $4 billion in 1981.

And we must be prepared to negotiate and reason together on taxes. We can and must hold tight on spending. But recent experience shows that the public will not accept the cuts needed to solve the problem exclusively on the spending side of the budget.

The public wants an adequate defense and it wants an adequate social insurance system for its retirees and disabled citizens. But the public also demands that government care for the veterans and the poor, that it have an effective FBI and IRS, and that flying on an airline be safe. It demands safe, efficient highways with bridges that don't collapse. We are misleading the American public if we go on pretending that those services can be provided at the present level of taxation.

Sometime soon, we must begin talking about how much additional revenue is needed and how it will be raised.

HOW DO WE REACH A SOLUTION?

Can our political system deal with these issues? I think so, but we haven't done it yet.

Last year, Congress and the President enacted the Gramm-Rudman-Hollings approach for reducing the deficit. The threat of automatic cuts was supposed to force the political leadership to make the "big decisions."

It didn't work out that way. To give credit where credit is due, I think the pressure of the deficit targets did cause Congress to be very tight last year. But we didn't deal with the big issues. Instead, we dealt with big gimmicks--the blue smoke and mirrors that legislators have been talking about.

The Gramm-Rudman-Hollings deficit target for 1987 is $144 billion. The law allows a $10 billion leeway, so the "real" target is $154 billion. In early October, there was great elation that the target had been "met." As a person who was involved in that process, let me tell you that the target has not been met, and will not be met.

Some of the "savings" that Congress and the President used to reach the target are not really savings at all--at least not the way you and I would use that term.

For example, Congress decided to raise money through the sale of loan assets. This would actually make the problem worse next year because of the loss of future income. This effect might be compounded by the way the Administration has planned to conduct the sales. The resulting low prices may require even more loans to be sold, further depleting future income.

Other "savings" are nothing but accounting tricks. A revenue sharing payment was made early so it would be booked in fiscal year 1986. Some military pay will be booked in 1988 by slipping a payday from September 30 to October 1.

The cash deficit for 1987 will be a good deal above the $154 billion target. OMB and CBO are now estimating it to be around $175 billion and that looks optimistic to me. Without the gimmicks, the number would be even higher.

Why do we keep trying to paper over the deficit problem? Mostly, it is the natural reluctance to face difficult and painful political choices involving basic disagreements over national priorities. But that reluctance is greatly intensified when the estimates and forecasts keep suggesting that continuing current policies will lead to a solution.

HOW CAN WE TRUST THE NUMBERS?

When our political leaders do not know what the real numbers are and cannot trust the numbers they are given, it becomes much easier to duck the issue. I believe that is one of our basic problems. It is unrealistic to expect a politician to vote for program cuts or tax increases that may cost him or her the next election when previous attempts to be courageous didn't solve the problem.

Also, too many people still believe the problem will go away if we just wait for the acceleration of economic growth. They believe that the economic boom and the tax revenues it will produce is just around the corner. If you are tempted to go along with them, let me remind you that New York City and the Penn-Central Railroad engaged in the same sort of thinking and lived to regret it.

Clearly, this is a matter of deep concern to me. I don't think we can solve the problem of the deficit--and keep it solved--until our political leaders are dealing with numbers they trust and in which we can all be confident. If we are to have numbers we can trust we need a basic overhaul of our financial management structure at the federal level.

Our federal accounting systems are in terrible shape. The basic structure was laid out in World War II, and many of the systems are built around 1950s vintage concepts and computers. The systems are highly inefficient and, despite the enormous cost of operating and maintaining them, they still don't produce the reliable, timely data needed for deciding policy or managing day-to-day operations.

The budget process is in equally bad shape. Our history of unrealistic economic forecasts has been well-documented. But the budget process itself adds to the problem. It is incredibly burdensome, complex, and repetitive, and consistently produces a misleading picture of the future. Congress' problems in producing a budget are obvious, because Congress must operate in the open. But I can assure you from my own experience that the executive agencies have equal difficulty in developing a budget.

I am convinced that it doesn't need to be this way. For several years the General Accounting Office has been urging the President and Congress to start on a basic rebuilding of our financial management structure and suggesting some ways in which it could be done. Some of our ideas were reflected in the President's State of the Union message. I am hopeful that the

Administration and the Congress can resolve their problems this fiscal year and reach a workable solution.

CONCLUSION

In summary, getting--and keeping--control over the deficit and the budget requires several things. First, we must know where we are. That means having a modern financial management system producing numbers we can trust and understand. It also means building realistic budgets around credible economic forecasts.

Second, we must recognize both the price we must pay for tolerating this huge debt, and the fact that the price will continue to rise the longer we live this way.

Finally, our political leaders must be willing to work together in developing a politically feasible and sustainable strategy combining reasonable restraints on spending with appropriate revenue increases until we work our way out of the problem.

And I do mean work; this problem will not solve itself.

As responsible citizens, it is our duty to insist that the problem be solved and to accept our share of the cost. Our government can live within its means, provide the services the American people demand, and build the basis for a healthy economy in the future.

These expectations are not unreasonable. We can meet them if we decide to do it. The longer we wait, the harder the task will be.

As for myself, I have great faith in the American people and the American system of government. When enough influential citizens--such as you--are convinced of the seriousness of this problem, I know we will solve it.

Thank you.

RESPONSES TO WRITTEN QUESTIONS SUBMITTED BY SENATOR ROTH

Question

1. Much of your testimony on Wednesday was devoted to the specific steps we must take to carry out the basic reform of our financial management and related systems in government. I would like to take a step back for a minute, however, and address the issue of leadership in the area of government management. How can we attain the centralized leadership you alluded to in your statement? If management leadership is not being asserted at OMB, as some have argued, where and to whom should this responsibility be assigned? For example, do you support the creation of a Chief Financial Officer for the federal government?

Response

Financial management leadership within the executive branch is crucial to accomplishing the significant reform efforts that are needed. The Office of Management and Budget (OMB) was tasked to fill that role. However, OMB's primary focus has been on developing and supporting the President's budget. Thus, management issues of all types have been overshadowed by OMB's budget responsibilities. Financial management leadership responsibilities should be removed from OMB to ensure that other interests do not distract attention from improvement initiatives. I believe that a chief financial officer position for the federal government should be established.

The chief financial officer, or equivalent, should be responsible for designing, developing, implementing, and monitoring the rebuilding of the federal financial management structure. Important duties would include developing a conceptual design to guide the rebuilding effort and an implementation plan to put the design in place.

The new office must have adequate funding to carry out its duties and an appropriate degree of independence and authority to ensure that operating agencies across successive administrations carry out the implementation plan. Establishing a stated term of office for the chief financial officer would provide continuity to the reform efforts.

Question

2. In 1982, this Committee developed and the Congress passed Prompt Pay legislation to ensure that the government pays its bills on time. Would you comment on the impact of this legislation and on what specific legislative steps we can take beginning in this Committee to improve the performance of the 1982 legislation?

Response

The Prompt Payment Act has resulted in substantial improvements in how federal agencies pay their bills. Our August 1986 report on governmentwide compliance with the act and related OMB and Treasury requirements showed a definite reduction in the number of excessively late payments. Also, substantially fewer early payments have saved hundreds of millions of dollars in Treasury borrowing costs.

However, there are still some serious problems with agency performance and with the accuracy of reports required by the act. Technical refinements to the existing prompt pay legislation and to agency regulations are needed to address lingering problems. The most serious of these involve eliminating unnecessary administrative delays in accepting goods for payment, ensuring that discounts are taken only within allowable periods, routinely paying any interest penalties owed, and upgrading OMB's annual report to allow effective congressional oversight.

We commented on S. 2479 passed by the Senate during the 99th Congress and are also offering our views on S. 328 introduced earlier this year. These bills address the weaknesses we identified, and with selective refinements, offer a good basis for amending the act. We are scheduled to testify on prompt payment before this Committee on March 19.

Question

3. In 1985, this Committee developed and the Congress passed the Single Audit Act, which as you know is designed to make more effective use of limited federal audit resources and to simplify the audit process for certain federal fund recipients. While the performance record for this legislation is somewhat brief, would you comment on how GAO views its effectiveness to date? Has the single audit concept improved auditing government-wide and are the various federal agencies using this approach as we had envisioned?

Response

We believe the single audit concept will improve auditing governmentwide, and we intend to determine how effectively the single audit legislation is being carried out. We believe enough time has now elapsed, and sufficient guidance has been provided, to allow those conducting single audits to perform them properly. We will begin a review of the implementation of the single audit concept during the summer of this year to determine its effectiveness to date, and to see if the federal agencies are using this approach as the Congress envisioned it.

Question

4. In 1982, we passed the Debt Collection Act. Again, we thought we were on the way to solving the problem of tremendous backlogs in collecting debts owed to the federal government and a lack of agency commitment to getting those dollars back to the Treasury. Your reports showed last year that we had over $25 billion in delinquencies, and that this amount was growing, not shrinking. I know the Administration has been working on this. What is the current situation on delinquent debt collections?

-- Last year the debt collection legislation that we reported from this Committee (title V of S.2230) would have provided a battery of new incentives to get the agencies moving on debt collection. Some have suggested that the current administrative directives of OMB will do the job, that new legislation is not needed. As you know I have my doubts about this position. What is your view on this?

Response

At the end of fiscal year 1986, delinquent non-tax debts owed to the government was about $26.1 billion. This is an increase of about $2.2 billion from fiscal year 1985.

One of the problems identified in our report, Debt Collection: Billions are Owed While Collection and Accounting Problems Are Unresolved (GAO/AFMD-86-39, May 23, 1986), was that many debt collection tools which were made available to the agencies by the Debt Collection Act, but not mandated, were not being implemented or used by the agencies. Enacting legislation which provides for mandatory use of debt collection tools, such as collection agencies and credit bureaus, and credit management practices, such as default and acceleration clauses and determining credit-worthiness, would help overcome this problem. Coupled with strong Congressional oversight and executive branch leadership, a comprehensive legislative package of tools and other initiatives could result in improving debt collection and credit management operations.

While the Office of Management and Budget believes that these things can be administratively accomplished because they are currently authorized under current law and contained in OMB Circulars A-129 and A-70, agencies have been slow in reacting in the past. We believe, therefore, that improved management techniques which are supported by legislative requirements would provide the greatest opportunity for agency implementation.

We share your interest in improving the government's debt collection and credit management operations, and we support legislative action in these areas.

Question

5. I've been very much impressed with the serious quality of the GAC's work with the general management reviews including Labor, Justice and DOT, for example. I know these don't make the evening news, but I also know that they generally have been well received by the agencies themselves and that they have taken advantage of your findings and recommendations. That's all to the good. Clearly, we need advance warning of management problems such as you provided on Wednesday in IRS, SSA and the farm credit system. But shouldn't that also be a crucial part of the overall management job in the Executive Branch? What do you view as the Executive Branch role in this area of management?

Response

The creation of OMB signified an explicit institutional commitment to a comprehensive and coordinated approach to government management issues. For many years, the efforts to strengthen public administration in the federal government have centered on solving management problems through centralized approaches. Your Committee has drawn on the work of GAO, the National Academy of Public Administration, the Grace Commission and others to document that OMB-led efforts of the past have generally had limited lasting results.

Recognizing this record, GAO believes that fundamental responsibility for successful management reform rests with the major departments and program agencies. Therefore, we have focused our initial general management reviews on departments and agencies such as the Departments of Labor, Justice, Housing and Urban Development, Health and Human Services, the Social Security Administration, the IRS, the Defense Logistics Agency, and the Environmental Protection Agency. Once we have completed reviews, we intend to follow-up with the agency, Congress, and OMB to ensure that progress is made.

While the program agencies have received our initial attention, we recognize the important role that the central management agencies, and OMB in particular, play in providing a framework within which program agency management improvement efforts can succeed. The central agencies can play a vital role in encouraging and supporting the efforts of the operating agencies and ensuring that the experiences of one agency are shared with others. We currently are assessing central agency performance in a number of management areas with the intent of recommending improvements in the manner in which they fulfill their responsibilities. We will continue to apprise the Committee of our progress.

GAO does believe that progress in improving the management of our major Departments and agencies will be limited until Congress joins with the President in fundamental reforms of our current budgeting and financial management systems. Those reforms must ensure that these systems serve to focus the attention of our key decisionmakers on the most pressing budget and management issues at hand.

ONGOING ASSIGNMENTS STARTED AT THE REQUEST OF SENATOR PETE WILSON, AS CHAIRMAN ARMED SERVICES COMMITTEE'S TASK FORCE ON DOD INVENTORY MANAGEMENT

Title: **Evaluation of Inventory Accuracy and Causative Research Within DLA and the Military Services**

The objective of this work is to determine whether DLA and the Services' physical inventory procedures ensure that inventories are accurately reflected on accountable records and that causative research of inventory variances is complete and effective. We will identify inventory adjustments and evaluate the causative research that was done and the way the managers used the resultant data to identify and correct inventory problems.

Title: **Evaluation of Contractor Access to the DLA and the Military Services Supply Systems**

The objective of this work is to determine whether DLA and the Services' have implemented effective procedures to ensure that contractors obtain from the supply system only the government furnished material they need to fulfill the provisions of the contract. Specifically, we will see how the Management Control Activities, which were set up to monitor contractor use of the supply systems, are carrying out their responsibilities.

Title: **Evaluation of Receipt Confirmation and Fast Pay Procedures Within DLA and the Military Services**

The objective of this work is to determine whether DLA and the Services' procedures effectively ensure that DOD receives what it pays for when expedited payment methods are used. At various wholesale and retail activities, we will select and trace transactions to determine whether material paid for is actually received and whether receipts are accurately and expeditiously reported to the wholesale inventory manager.

Title: **Review of Cataloging and Standardization Policies, Procedure, and Practices**

Our survey of the Federal Catalog System identified many problems in item identification, item entry, and item deletion. Many of these problems can be attributed to information voids and inadequacies in the Federal Catalog System that permeate the entire supply system. The objective of our review is to determine what information is needed and why it is not being provided.

Title: Evaluation of Implementing Private Sector Inventory Management Practices Within DOD

The objective of this assignment is to evaluate private sector inventory management practices to see if they can be used within DOD. We will visit industrial and distribution firms that have similar operations to DOD maintenance and supply activities and identify key functions that we need to evaluate for DOD application. We will also determine how inventory levels and inventory accuracy at these firms compares to corresponding DOD inventories.

Title: Air Force's Management of Unserviceables

The objectives of this work are to look at Air Force controls over unserviceables to determine potential impacts upon depot repairs, additional purchases of replenishment parts, and readiness; and probable causes for identified deficiencies and delays.

Title: Provisioning for Air Force Weapons Systems

The objective of this assignment is to examine and evaluate how decisions concerning such things as, requirements, stockage objectives, program factors, and parts pricing and cataloging, are made and validated during the provisioning process. The assignment will also evaluate provisioning for the B1B Bomber.

Title: The Navy's Requirements Determination Process for Materials

This assignment will study the overall requirements determination process and the Navy's management system for evaluating this process.

Title: Navy Policies and Procedures for Determining Initial Spare Parts Requirements for Aircraft

The objective of this assignment is to determine whether Navy policies and procedures for making initial spare parts determinations adequately ensure that the items required to support and maintain new end items will be available when and where needed.

Title: Evaluation of Security of DOD Assets

The objectives of this assignment are to (1) analyze identified weaknesses to see if the problems were correctly defined, (2) evaluate the appropriateness of Navy's corrective actions, and (3) identify additional actions Navy needs to take to improve internal controls over its security procedures.

Title: Evaluation of DLA and the Military Services' Receipt, Storage, and Issue Procedures at the Retail Level

The objectives of this assignment are to identify material receipt, storage, and issue policies, procedures, and practices and to evaluate their adequacy through testing actual transactions at retail supply activities.